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VOL. 74, NO. 1

Nation's Business

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THE NATION'S BUSINESS

Disgruntled employees are filing more unjust-discharge suits against smaller companies. Preventive measures can reduce the chances of such suits. (Page 13)

PHOTO: DICK LURIA—FOLIO

COVER STORY

What are the signals telling economists about the business outlook in the new year? An annual NATION'S BUSINESS *survey covers the subject from high tech to health costs, from finance to freight.*

PHOTO: KEN BIGGS—AFTERIMAGE

Cover: Vignelli Associates

DEPARTMENTS

MANAGING YOUR BUSINESS

Fillmore Crank, Sr., (second from right) and wife Beverly Garland (left) are preparing well in advance for passing on their business to their children in the fairest way. (Page 32)

PHOTO: T. MICHAEL KEZA

PEOPLE/PERSONAL

Rex Maughan's interest in accounting and his interest in owning his own company combined successfully with the aloe plant in Forever Living Products. (Page 89)

PHOTO: TERRENCE MOORE—BLACK STAR

TECHNOLOGY

The AT&T breakup has confronted many small businesses with too many options at prices beyond their means. But some are learning how to take advantage of the changes. (Page 80)

PHOTO: T. MICHAEL KEZA

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JAMES J. KILPATRICK

Rhyme Without Reason

For all the speeches back home, the press releases on the Hill, the oratory on the floor, Congress has yet to get serious about cutting the federal deficits. There is simply not the will to do what manifestly has to be done.

Members will not vote to eliminate nonessential expenditures. Consider, if you please, the National Endowment for the Arts.

On the afternoon of October 10 the House voted to authorize up to $167 million to finance the NEA in fiscal '86. The bill also authorizes $140 million for the National Endowment for the Humanities and $22 million for the Institute of Museum Services. The institute exists to give federal money to local museums. A week earlier the Senate had passed substantially the same legislation.

Culturally, so far as the federal taxpayer is concerned, we are all fixed for the coming year.

Tucked away in the National Endowment for the Arts is a program of grants to poets. Within the vast mural of a trillion-dollar budget, these subsidies are barely a flyspeck on the wall. Proponents of the bill kept reminding the House of that fact. These are just teensy-weensy little handouts, compared to what is spent on an aircraft carrier, and the grants mean so *very* much to the struggling grantees.

This is how the program works. Any person who has published a volume of at least 48 pages of what he regards as poetry, or has had at least 20 poems published in magazines or anthologies, may apply to the NEA for a grant to support his literary efforts. Last year roughly 1,100 hopefuls applied; 126 of them got grants of $12,500 each. Over the past 20 years, the NEA has subsidized 1,429 poets. That may seem an incredible statistic, but it comes from one of the bill's prime sponsors, James M. Jeffords (R-Vt.). Think of it! Fourteen hundred certified poets! It is a depressing thought.

What kind of poetry is this? Sight unseen, I can tell you that most of it is drivel. It is largely free verse. It has no rhymes (heaven forfend that a poem should rhyme!), and it has no particular meter to speak of. Robert Frost compared the writing of free verse to playing tennis without a net. Any gifted child can pull off the trick.

During the brief House debate on October 10, Rep. Tom DeLay (R-Tex.) alluded critically to some of the alleged poems submitted by some of the applicants to support their bids for federal grants.

He would have read these remark-

How can we justify outlays of taxpayers' money to support poets?

able specimens on the floor, but the rules of the House forbid the publication of obscenity in the *Congressional Record.*

One such "poem" dealt with the fond thoughts of a homosexual for his lover after engaging in sodomy. Another specimen, this one by a woman, provided an explicit description of an act of oral sex. Her extended paragraph was not significantly better than any given paragraph, any month, in the raunchy letters column of *Gallery* magazine. Other submissions cannot even be described in NATION'S BUSINESS. Justice Potter Stewart once said that he couldn't define obscenity, but he knew it when he saw it. Some of this stuff is patently obscene.

Well, said Jeffords defensively, the horrid examples came from only eight of the 1,429 poets who had received federal grants, and all of the offending stuff had been written prior to the handouts. All told, DeLay was complaining about only four pages of free verse in 2,260 pages included with the applications.

That defense of the grants is fair enough as far as it goes, but it leaps nimbly over a threshold question: How can we justify outlays of the taxpayers' money to support *any* poets? It cannot be done.

Some of the NEA grants to symphony orchestras, established ballets and choral groups may be defensible, but not even the most tortured construction of the Constitution will support the notion that a $12,500 grant to a fruitcake poet promotes the "general" welfare. It promotes the fruitcake.

It may be that among the 1,429 soup line poets there will emerge another Robert Frost, another Emily Dickinson, another Whitman or Sandburg or Lowell. Maybe.

I would contend that the truly exceptional poets would emerge anyhow, grant or no grant. They always have. The arts and humanities grants that go to 1,429 individuals do not go to Nos. 1,430 and 1,431. Their work is only marginally poorer than the work of Nos. 1,428 and 1,429, if it is poorer at all, but they do not share in the federal largess. The winners are officially, governmentally certified; they are poets, and here are the grants to prove it. Hokum!

Let me return to the point of beginning.

Our government has a national debt of two trillion dollars, and that incomprehensible figure does not include contingent and unfunded liabilities of many billions more. We have been rolling up deficits for the past five years that have wildly distorted our economy. It is of the most urgent, compelling necessity that we get our fiscal house in order. Toward that end, the frills—the merely pleasant programs—have to go.

Every dollar counts, including every dollar spent on poets whose pretensions outstrip their talents. Members of the House know this. They talk about the deficits all the time. But on October 10 they voted these authorizations, and the vote was 349 to 57. NB

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LETTERS

A Piggyback Tax?

I am all for a national sales tax [Where I Stand, November]. Sales taxes are the fairest of all the taxes that we have in this country.

However, I am not for a sales tax *and* an income tax. Just tax us one time real hard on the "front end," and leave the income tax off.

In my opinion, certain items should not be taxed more heavily than other items. Instead, the same percentage should be applied, straight across the board, at a level high enough to supplant all income taxes.

This way, the national sales tax could be added on top of each state's sales tax. When each business turned in its sales tax receipts to the state, the national sales tax could be entered on the same form. The federal government would get its tax money quickly and effectively, without the hassle of collecting income taxes.

Ron Rahaim
Mayor
Town of Richton, Miss.

The Turning Point

I am afraid that James J. Kilpatrick ["America's Next Bicentennial," October] has bitten off more than he can chew.

If he believes that the Supreme Court's decision in *Marbury v. Madison* (1803) was the beginning of the downhill slide of states' rights, he should take into account this statement from that decision: "All laws which are repugnant to the Constitution are null and void."

Ergo, states' rights were still protected under Articles I, IV and V, as long as the states made the federal government act accordingly.

Look to the passage of the 14th Amendment in 1868 as the actual start of the demise of states' rights. The crowning glory, for those who wanted a federalist democracy (anarchy), rather than a representative republican form of national government, was the ratification in 1913 of the 17th Amendment, requiring the direct election of U.S. senators.

In my mind, and in those of all true patriots, 1913 is remembered as a year of infamy. It was also the year when the 16th Amendment, authorizing a federal income tax, was foisted upon the American people by the fraudulent acts of the Secretary of State, the solicitor general, Congress and the legislatures of the several states.

Thomas O. Case
Lebanon, Ore.

'Twas Ever Thus

James J. Kilpatrick ["A Tangled Separation," November] makes a useful point about church and state issues when he says, "We've argued these issues since ... 1789, and we'll be arguing them for years to come."

As long as people in high places insist on keeping the argument going, it will continue. When these people decide to say "enough," because the only cause being served is one of divisiveness, perhaps it will stop.

What reason is there for keeping it going?

Alvin Birkholz
Miles City, Mont.

Flying Fingers

W.L. Tucker [Letters, November] did an excellent job of setting the record straight on the Dvorak keyboard and its users' failure to win speed typing championships.

My father was seven times world champion on the Underwood and later

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This is the key finding of a major new survey of America's leading companies. The survey, commissioned by the Tobacco Institute and completed early in 1985, was conducted by the Human Resources Policy Corporation of Los Angeles among the *Fortune 1000* service and industrial companies and *Inc.* magazine's 100 fastest-growing companies.

Only about one-third of the responding companies said they had any official smoking guidelines in effect. Furthermore, the reasons most frequently given centered around common-sense situations where workers dealt with hazardous substances, sensitive equipment or food. And almost half of these policies had been in effect for over five years.

Two-thirds of the companies reported they prefer to encourage individual workers to settle smoking issues with mutual respect for each other's legitimate rights and feelings.

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VOTE IN THE BEST BUSINESS ADVERTISING AWARDS POLL IN THE FEBRUARY ISSUE.

Nation'sBusiness

LETTERS

on the Royal standard. He spent his life training on the QWERTY keyboard and won all his championships on it. In my childhood there was periodic dinner table conversation about alternative keyboards, and my father always noted inferior speed results on the Dvorak and others.

You may have quoted accurately, in your editor's note, from the *Journal of Information Processing,* but the *Journal*'s information is inaccurate. "That the winners used [the Dvorak keyboard] was often very carefully suppressed" is a statement that has absolutely no basis in fact.

Albert L. Tangora
Mexico, Mo.

A Painless Cure

The Social Security system's problems can be cured painlessly.

We all know that a very large sum of money will grow quickly as it draws compound interest. Thus, if Social Security had a $100 billion fund to invest, it could spend $10 billion more each year without invading the fund itself.

How can we start putting such a huge fund into place right now, without raising taxes a dime?

By beginning a national lottery. All profits would go directly into a new Social Security Superfund. Each year, for 15 years, more lottery profits and the proceeds from compound interest payments swell the fund, until we begin to reap what we have sown. All investment proceeds (excluding the return of principal) are now used to increase Social Security payments to the elderly. Meanwhile, the Superfund will still be growing with yearly lottery profits.

Let's start now—because we're *all* getting older.

Joseph Mitchener
Salinas, Calif.

Lifting The Veil

We should not try to impose an artificial veil on the reality of the relationship between the United States and the Soviet Union.

The fundamental reality is that the relationship is competitive, not cooperative. Soviet violations of past arms agreements, including those having to do with missile defense, are well known. Soviet leaders are inflexible in arms negotiations because any softening on a leader's part can lead to loss of control at home. A possible threat from the United States is used to hold the Russian people hostage because they have little in common with their ruling

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LETTERS

elite. So, regardless of their domestic problems, a powerful military machine guarantees Soviet leadership control.

This is why the Soviets build weapons instead of automobiles. Any rivalry with the West cannot, therefore, be peaceful. Maintaining a military balance is the only solution.

Dailey J. Berard
President
Universal Fabricators, Inc.
New Iberia, La.

Sharing The Savings

James J. Kilpatrick ["An Off-Balancing Act," July], in opposing a balanced budget amendment, ignores political necessity. Today's politicians need—must have—some sort of restraint, and nothing else has worked. On the other hand, your editorial in support of an amendment ["A Long Overdue Amendment," July] does not respond to any of Kilpatrick's objections.

My own solution originated as a tongue-in-cheek approach to government spending but can now be looked upon as virtually foolproof. The "McDevitt Plan" is as follows:

Every person who is in any way responsible for budget requests will be given 10 percent of any dollars saved over the previous year's request—tax free. Should the reduction require the elimination of jobs, the workers affected could share in the savings on a one-time basis. Bonuses of more than, say, $100,000 could be paid over a period of five years, thus giving the government time to collect interest on the amount to be paid.

To protect against too-deep cuts in programs dear to the hearts of spending politicians, oversight committees would be formed, made up of the most liberal politicians available. It would be their responsibility to question the validity of the proposed cuts—the adversary system at its best!

Dan McDevitt
Economics Instructor
John Carroll High School
Fort Pierce, Fla.

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Alan L. Townsend
Lincoln, Nebr.

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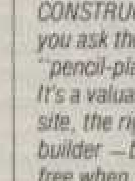

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Washington Roundup

Battles for business on Capitol Hill; tax deductions made easier; credit card interest ceilings.

Going Backward With "Tax Reform"

Sen. William L. Armstrong (R-Colo.) urges business to "be militant" on tax and spending issues and not to back away from them.

Business people should take the lead in fighting tax reform and spending control battles, a member of the Senate Finance, Budget and Banking committees says.

"The House's tax bill is not 'reform' by any reasonable definition, but it won't go away," Sen. William L. Armstrong (R-Colo.) warned business leaders at a recent closed-door meeting in Washington.

"Be militant. Don't back away from the tax and spending issues," he told directors of the U.S. Chamber of Commerce. "Business' allies on Capitol Hill fighting these battles need your support."

The Chamber, the National Association of Manufacturers and the Business Roundtable are among major business organizations opposed to the House tax bill because of its potential impact on economic growth.

House-proposed cutbacks in depreciation allowances and the investment tax credit alone would retard growth by increasing the after-tax cost of capital by as much as 20 percent, a Chamber computer model of the economy predicted.

And the overall House proposal would stunt growth of the gross national product by $145 billion while increasing the unemployment rate by 1.3 percentage points from 1986 to 1991, according to the econometric model of Lawrence H. Meyer & Associates, a St. Louis consulting firm.

Armstrong and the business groups agree that Congress should now expend its fiscal energy on achieving permanent spending controls, including a constitutional amendment requiring a balanced budget.

The Immigration Law's Reporting Burden

The House Judiciary Committee is putting the finishing touches on H.R. 3080, a proposal by its chairman, Rep. Peter W. Rodino, Jr., (D-N.J.) to overhaul U.S. immigration laws and grant citizenship to many aliens residing here illegally.

Business has launched an all-out assault on this Immigration Control and Legalization Amendments Act. Opposition is due in large part to the bill's paper work requirements and to establishment of a new civil rights agency to monitor business hiring and firing practices.

The measure would require even the smallest of employers to verify job applicants' citizenship and keep records. Business people could be fined for technical paper work violations even if they never hired an illegal alien.

Employers are complaining about being pressed into service as "immigration officers" at a cost to them of $651 million a year, according to the Small Business Administration's Office of Advocacy.

Business lobbyists are urging representatives to adopt the Senate approach to immigration law reform: optional recordkeeping and retention of the present civil rights bureaucracy.

The immigration bill passed September 18 by the Senate would allow businesses to decide whether to maintain citizenship records of new hires.

While this would be cumbersome, the optional records would provide an affirmative defense against charges of knowingly employing illegal aliens.

Under both the Senate and House proposals, employers would be fined heavily or sent to prison for knowingly hiring illegal aliens repeatedly.

Recordkeeping For Deductions

The Internal Revenue Service has made it easier to document two of the most common business income tax deductions. They are use of personal property to earn income and personal use of company property.

Under newly proposed IRS rules, effective January 1, taxpayers can substantiate deductions for "mixed use" of property such as automobiles and light trucks with documents kept for other business purposes.

Business people who do not generally record property use daily must document deductions by establishing logs and posting them "while their memories are still fresh."

However, they must maintain these logs only long enough for the IRS to establish a ratio of personal to business use.

Original IRS rules, proposed a year ago, would have required taxpayers to

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"The international market has great potential for us, but first we need feasiblity study assistance."
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PHONE ( ) ________ TELEX ________
COMPANY'S ANNUAL SALES: $ ________

NB 16

Circle No. 6 on Reader Service Card.

New Internal Revenue Service rules will make it much easier for business people to substantiate tax deductions for "mixed use" of property such as light trucks.

PHOTO: IRENE S. MORRISSETTE

maintain "adequate contemporaneous records."

That threatened recordkeeping burden elicited a deluge of protest letters from angry taxpayers and business groups to IRS Commissioner Roscoe L. Egger, Jr., and quickly forced revocation of the proposal.

The new IRS proposal also deals in detail with such matters as reporting employee use of company vehicles for commuting and other personal reasons, and withholding tax due.

Business owners and employees who use company property for pleasure or their own property for business should contact their bookkeepers, accountants, tax lawyers or income tax return preparers to determine how the new proposal applies to them.

Credit Card Interest Caps: Potential Disaster

Business is keeping a close watch on proposals before the House Banking, Finance and Urban Affairs Committee to cap credit card interest rates.

The legislation, which would supersede generally less restrictive state usury statutes, would establish floating ceilings on those rates, tied to the three-month Treasury bill or Federal Reserve Board discount rates.

The measures' proponents want to preclude "gouging" of unsuspecting consumer borrowers.

However, their business opponents warn of potential undesirable side effects.

When demand for credit outstrips the supply available at the ceiling rate, they point out, lenders naturally favor their most creditworthy customers.

In these cases, low-income and small business borrowers cannot obtain credit.

The only comprehensive study of this issue, according to the U.S. Chamber of Commerce, detailed the impact of a 10 percent interest rate limit imposed in Tennessee during 1974-76.

This 1977 study, by the University of Tennessee, Knoxville, concluded that the credit cap resulted in average annual loss to the state's economy of $150 million in output, $80 million in retail sales and 7,000 jobs.

Capital Update

Franchising Assistance

Do you own or manage a franchise operation? Are you thinking about buying one?

If so, you may want to attend one of six franchising conferences to be held this year by the Small Business Administration and International Franchise Association.

Sites and dates are New Orleans, March 21; Houston, April 10; Detroit, May 16; Los Angeles, June 13; Philadelphia, August 22; and Chicago, September 12. The registration fee is $15.

For details on seminar topics or to register, write SBA/IFA Franchising Conference, Box 35033, Washington, D.C. 20013.

Pension Reform

Three leading employer organizations have asked Congress to safeguard the financial security of the Pension Benefit Guaranty Corporation's single employer termination-insurance program.

The program, established under the Employee Retirement Income Security Act, assures that vested employees would receive defined retirement benefits if their employers terminated their plans.

The U.S. Chamber of Commerce, the National Association of Manufacturers and the National Association of Wholesaler-Distributors have written the House and Senate labor and tax-writing committees that reforms must be enacted to "promote the formation and maintenance of defined benefits plans and assure the retirement income security of American workers."

These groups also oppose further PBGC premium increases unless reforms are achieved.

King Holiday Activities

E.G. Jefferson, chairman of E.I. Du Pont De Nemours & Company and an official of the Martin Luther King, Jr., National Holiday Commission, is seeking business' participation in ceremonies and activities nationwide January 20, the first observance of the national holiday honoring King.

President Reagan, Congress and many business organizations are supporting this effort. To learn how to get involved, call the commission at (202) 755-1005.

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Obtain the Property Report required by Federal Law and read it before signing anything. No Federal agency has judged the merits or value, if any, of this property. An Offering Statement filed with the New Jersey Real Estate Commission neither approves the offering nor in any way passes upon the merits and value of the property. Obtain the New Jersey Public Report and Broker's Release from the registered New Jersey Broker and read it before signing anything. (NJA No.C100-1083REV-GA) The Branigar Organization holds an Ohio Dealer's license and is the registrant offering this property for sale. A Statement and Offering Statement has been filed with the Secretary of State of the State of New York. The filing does not constitute approval of the sale or lease or offer for sale or lease by the Secretary of State or that the Secretary of State has in any way passed upon the merits of such offering. A copy of the Offering Statement is available, upon request, from the Subdivider). (NYA-No.83-220)(MI-83-219)

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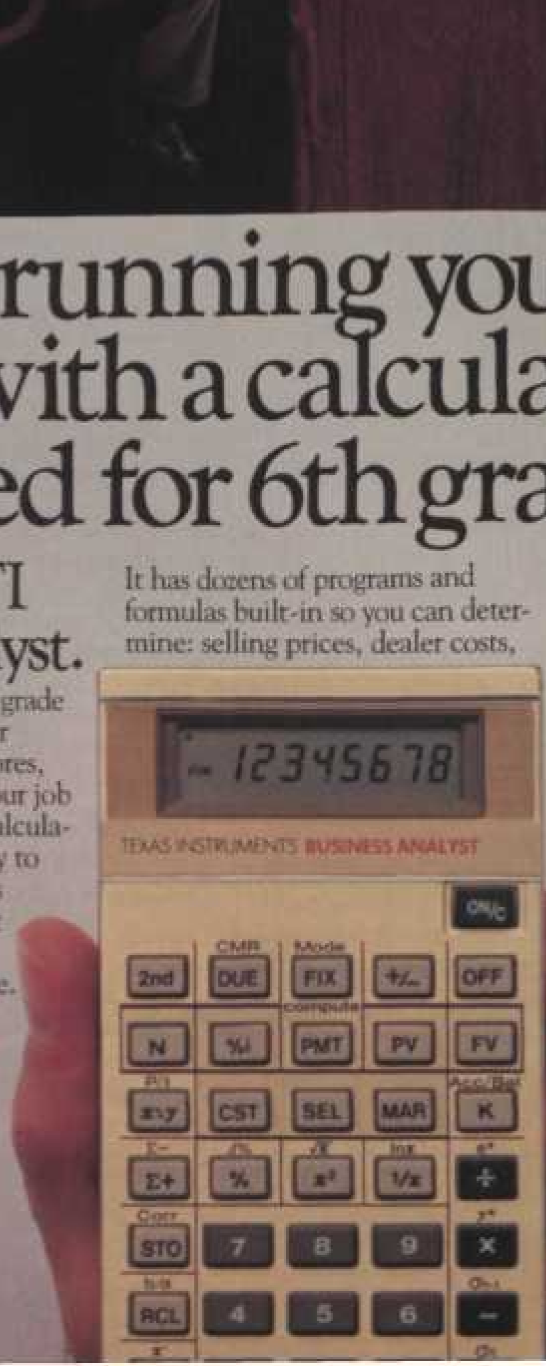

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Small Business Report

Protecting yourself from disgruntled employees; prompt payment from government agencies; the entrepreneurial right stuff.

By Mary-Margaret Wantuck

Avoiding Employee Lawsuits

Clerical workers are more likely than professional staff to file unjust-discharge lawsuits against small firms. A suit can drag on for two to four years before settlement.

Smaller companies are now finding themselves the targets of unjust-discharge lawsuits filed by disgruntled employees.

A national survey of 550 small and medium-sized firms found that more than 50 percent of the 295 respondents had faced at least one such suit. Estimates vary on the number of suits filed annually—the range is from 5,000 to 10,000. The Administrative Management Society, which conducted the survey, says most employees who sued were from the clerical ranks.

The Research Institute of America, which provides business, legal and tax advisory services to smaller firms, says there are two basic types of employee lawsuits: the implied contract suit and the public policy suit.

In the first, "an employee may try to make a claim based on a statement made by the employer or found in an employee handbook that he's been guaranteed a job for a specified amount of time," says institute spokesman Bill Keenan. "This kind of suit can also be filed if the employer neglects to warn the employee of his or her failing situation, before firing."

Keenan says that public policy suits are usually brought by employees who have been terminated for "doing something that is protected by law or public policy"—filing a workers' compensation claim, filing for bankruptcy, leaving work briefly to vote or serving jury duty, for example. They are also brought by workers who are fired for refusing to take part in something they think is illegal, such as an employer's order to exaggerate the actual costs of a project for tax purposes, says Bruce Wackowski, a legal editor at the Research Institute.

Employers can avoid getting entangled in an unjust-discharge suit, says the Administrative Management Society, if they conduct regular performance appraisals that are specific, objective and quantifiable; maintain accurate records; establish grievance procedures to handle employee complaints; review all dismissals; and avoid actions or statements that "imply a commitment to job security."

PHOTO: DICK LURIA—FOLIO

Other suggestions include having employers provide all employees with a manual describing company policies, rules and practices; refrain from making critical remarks about the dismissed employee to prospective employers; and be able to present documented evidence that the dismissal was handled objectively.

Unless they take these preventive measures, employers will lose, Keenan says. A California study on the number of unjust-discharge suits brought in the state revealed that 80 percent of the suits that come to trial are settled in favor of the employee and that the average settlement is $400,000.

Getting Started

There is no one way to make it as an entrepreneur, says Geoffrey Kessler, president of Kessler and Associates, a small business consulting firm in Los Angeles.

"Everybody differs when it comes to entrepreneurship," he says. "The secret lies in discovering one's own skills and resources and then applying them to the market's changing wants and needs."

Another important step for the fledgling entrepreneur is adapting an idea to high potential markets based on current social trends. Kessler says the fields best suited to entrepreneurial activity include leisure/recreation, health services, training, specialty goods and time-saving products.

Kessler recommends entering a field slowly by working in it. When a high level of familiarity and confidence has been reached, then it is time to start a part-time, low-capital, low-skill, low-risk operation, he says.

Another Kessler warning is to avoid borrowing huge sums in the beginning.

The last bit of counsel from Kessler is to have fun. "Many people fail because they try too hard and want to do everything themselves, working 16-hour days, which is extremely counterproductive. Entrepreneurs need time to develop ideas."

Making The Feds Pay On Time

With the Prompt Pay Act now in force, audio-visual dealer Henry March finds the federal government paying its bills on time.

When Congress passed the Prompt Pay Act in 1982, businesses, particularly small firms, breathed a collective sigh of relief. The law requires any federal agency that hires a private contractor to pay its bills within a certain time or face interest penalties.

"Before the law was passed, we were damn frustrated trying to get the government to pay its bills," says Henry March, president of Jasper Ewing & Sons, Inc., a small audio-visual dealership in New Orleans. "We were just being run around in circles. At least now, the government knows that if it doesn't pay up on time—either by the specified contract date or within 30 days after receiving the goods or invoice, it's going to have to pay interest, and is going to have auditors breathing down its neck wondering why payment was late." The interest rate is set by the Treasury Department every six months.

The law's results are impressive: 99 percent on-time payments versus 60 percent before enactment.

Business is now getting tough with state governments. Forty-one states and the District of Columbia have prompt pay laws, but in states without them, "small companies still are being paid three to four months later than the contract date specified," says Kenton Pattie, director of the Coalition for State Prompt Pay.

"For minority and women-owned businesses in particular, this has entailed going to the bank with their accounts receivable sheets on a monthly basis just to borrow enough cash to pay their employees' salaries."

Legislatures are considering prompt pay laws in Alaska, Illinois, Nebraska, Vermont, Massachusetts, New Jersey, Pennsylvania and Wisconsin.

But there are still some rough spots—both on the state and federal levels.

Pattie says there are agencies in some states that are thwarting prompt pay laws.

"We're working to win adoption of amendments such as automatic payment of interest and prompt pay by local governments that buy goods and services with state funds," he says.

The most notorious federal culprit is the U.S. Navy. Pattie describes a typical case: "A small company receives a Navy contract for generators that have to be delivered to Biloxi, Miss., Norfolk, Va., and San Diego. The firm diligently gets the order out. When the Navy receives the generators, they have to be tested. This can take anywhere from two to three months. Then all the paper work has to be sent to a central accounting office which may be in an entirely different city. The next step is to match everything up—contract, purchase order and invoice. Only after this is done does the Navy start counting the 30 days it has before incurring interest penalties."

PHOTO: D.E. ARNOLD

Pattie says that Congress may be "revisiting" the Prompt Pay Act this year to see what progress has been made and what improvements still are necessary. "Small business should not have to absorb the costs of government inefficiency," he maintains.

Small Notes

☐ Small companies with 200 to 500 employees are rapidly shifting to self-funded health insurance to hold down rapidly rising costs, reports the Self Insurance Institute of America. Between 30 percent and 40 percent of small businesses have some form of self insurance.

Self-funding plans improve cash flow because health care costs are paid only as incurred, and they are exempt from state premium taxes.

☐ The National Advisory Council of the Senate Small Business Committee, composed of 25 owners of small businesses, recently approved several resolutions.

The resolutions call for opposing comprehensive tax reform with the exception of a minimum corporate tax; maintaining the Small Business Administration as an independent agency; supporting vigorous enforcement of U.S. antitrust laws; hearings and a federal standard on the issue of liability insurance; and stronger implementation of the Prompt Payment Act.

☐ Dun & Bradstreet Corporation's annual survey of the nation's small business leaders finds their economic optimism for 1986 at its lowest level—down to 62 percent—since the survey was begun in 1981. The cash-flow squeeze, brought on by low inflation and relatively high interest rates, and the need for qualified, motivated employees were the biggest headaches cited by the survey respondents.

☐ In a new book—*The E-Myth*—Michael Gerber, president of the Michael Thomas Corporation, a California firm that specializes in small business development, tells why most small companies fail and what to do about it.

Most start-up businesses are doomed, says Gerber, because they are founded not by entrepreneurs but by "technicians" who lack the perspective and skills required to make a business work. Gerber adds that the problem is compounded "by the fact that everybody who goes into business is actually three people in one: the entrepreneur, the manager and the technician. Each of these personalities wants to be the boss. But none of them wants to have a boss. So they start a business together in order to get rid of the boss. And the conflict begins."

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Tiltmaster W7 27,500-lb. & 29,700-lb. GVWR	142 165 181 197	48.6 54.5 58.1 63.0	116 140 156 171	76.4 76.4 76.4 76.4	5.8 Liter Turbo Diesel 6-cyl.

*Effective measurement (accounts for 5" air intake).

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PERSONAL

For Your Tax File

Don't leave the documentation of gifts till the last minute. Also: The IRS is clamping down on changes in rollovers.

By Gerald W. Padwe, C.P.A.

Better To Give?

Owners enjoy tax breaks by donating cars to charity. Goodwill Industries Washington, D.C., branch Sales Manager Jeru Bashir (right) inspects a new arrival.

PHOTO: DAVID WOODELL

April 15 probably seems a long way off as you leave Christmas behind and look forward to the Super Bowl. At the risk of ruining your New Year, however, duty requires us to remind you that it is never too early to be thinking about your individual tax return, particularly if you gave property as a charitable contribution in 1985.

If you gave property to a charitable organization, and the total value of all contributed property exceeds $500, the Internal Revenue Service has a new form for you to fill out: Form 8283. It requires certain information about the property including a description of the donated property, the date of the contribution and your cost. You will also need to indicate the fair market value of the gift and how that value was determined. If you gave less than the entire interest in the property to charity or imposed restrictions on the contribution, the form asks for that information.

When the value of contributed property exceeds $5,000, you and the charity need also to complete Section B of Form 8283. This section first requires a donee acknowledgement, in which the organization states that it is a charity and that it received the property you are claiming as a deduction. The charity must also agree to give both the IRS and you a Form 8282 (Donee Information Return) if it disposes of the property within two years after the date received.

Section B also requires a certification by a qualified appraiser of the property's value where it exceeds $5,000 (except publicly traded securities). The appraiser must state that his fees are not based upon a percentage of the appraised property value. Finally, the appraiser has to acknowledge that a false or fraudulent overstatement of the property's value may subject the appraiser to penalties.

Don't delay gathering data. It might be more difficult to obtain necessary certification.

Gerald W. Padwe is national director-tax practice for Touche Ross & Co. For Your Tax File *is an information service for readers. See tax and legal advisers on specific cases.*

No More Second Look

The IRS has decided that a taxpayer can't change his mind. The subject is rollovers of lump-sum distributions from pension and profit-sharing plans.

An employee who receives a lump-sum payment of his benefits under an employer's pension or profit-sharing plan often can choose between a tax-free rollover and special 10-year averaging rules. If he rolls the lump sum over to an Individual Retirement Account, he pays no income tax until the rolled over amounts are paid to him from the IRA. If he elects 10-year averaging, the lump sum is taxed currently, but at a much reduced rate. A special form with the taxpayer's regular income tax return is sufficient for averaging, but a tax-free rollover must be made within 60 days after the lump sum is received.

In earlier private rulings, the IRS allowed a taxpayer who could not decide between a tax-free rollover and 10-year averaging a chance to change his mind. It worked this way:

The taxpayer rolled over the lump sum to an IRA within 60 days after he received it. He changed his mind and elected 10-year averaging when he filed his regular income tax return. The 10-year averaging election meant that the rollover was no longer a rollover but, instead, an excess IRA contribution. Before the April 15 due date, the taxpayer made a tax-free withdrawal of the excess IRA contribution.

The IRS ruling meant that a taxpayer was not limited to the 60-day rollover period in deciding which tax treatment—rollover or 10-year averaging—was most advantageous. He could make the rollover within the 60-day period but take a second look on April 15. No more. In a recent private ruling, the IRS concluded that the rollover cannot be revoked. Electing 10-year averaging does not make the IRA rollover contribution an excess contribution. Thus, when the taxpayer withdraws the rollover—even if it is before April 15—the withdrawal is taxed in full as ordinary income.

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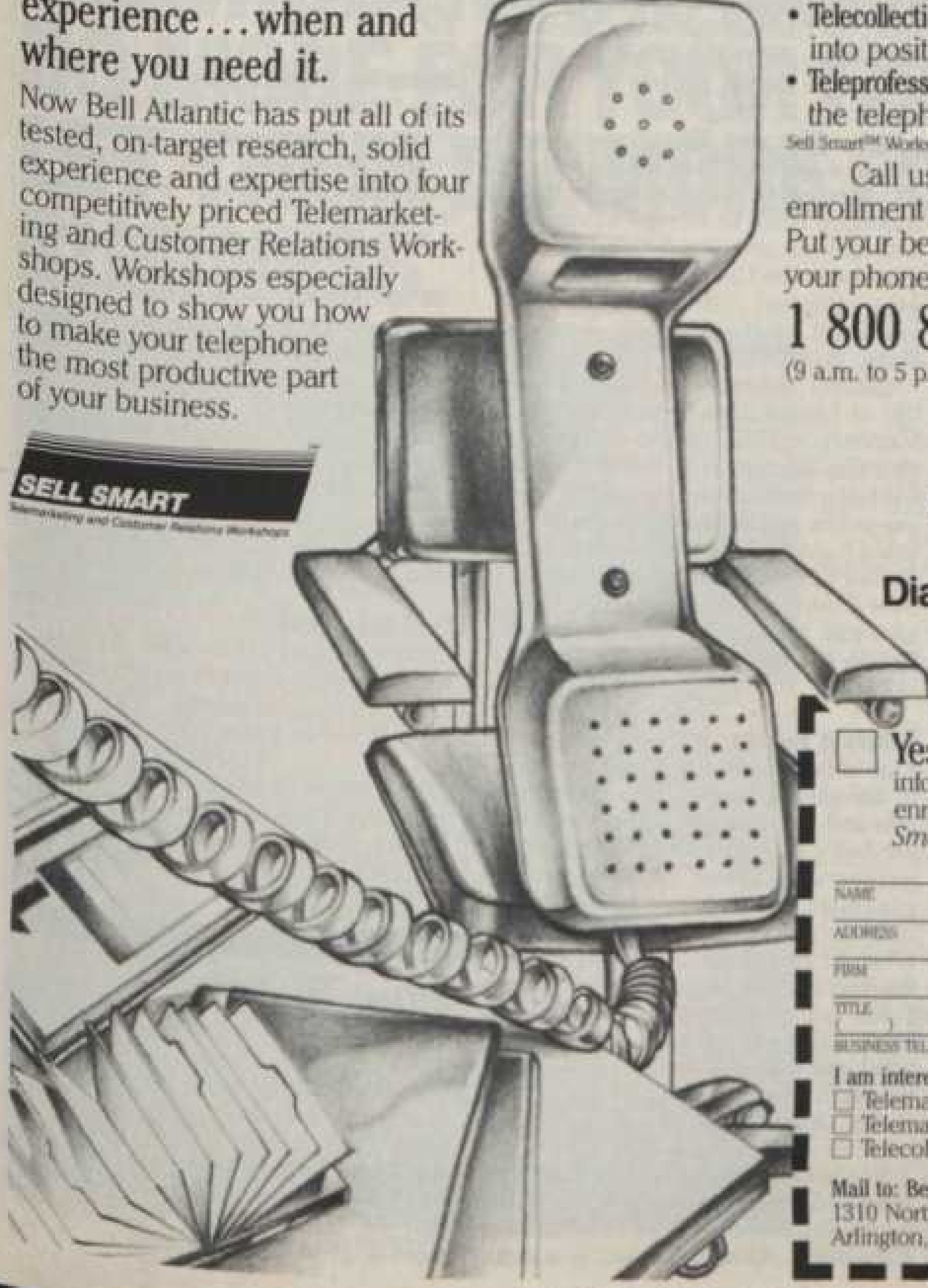

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C.J.F., Katy, Tex.

To protect your right to full use of your logo, you must apply for a trademark. A trademark is issued for any distinctive word, symbol or device used by a manufacturer, merchant or business person to identify goods and services. To apply for a trademark, write to the Commissioner of Patents and Trademarks, Washington, D.C. 20231.

Once you have filled out an application, send it along with a copy of your logo and a nonrefundable check for $175 payable to the U.S. Patent and Trademark Office. Expect to wait four to six weeks for a confirmation that your packet has been received.

Your application and logo will go through approximately 14 months of review and other registration procedures from the time it is filed to the time it is registered. If your logo meets all the criteria, it will be registered with the government—indicated by an encircled letter "R." Trademarks are registered for 20 years with the option for renewal rights.

Helping Employees Adjust

My new business is showing a promising future, but local technical talent is scarce. So I must scout around the country looking for qualified staff. I want to make relocation for my new employees as easy as possible. How can I help them and their families adjust to their new lives?
M.L.H., Livingston, Mont.

If you plan to hire extensively from other parts of the United States, you may decide to develop a program to help ease your employees into their new job and neighborhood. This might include assembling a standard packet of information about your company, the town, churches, schools, libraries, civic groups and recreation opportunities. Your local chamber of commerce probably has informative brochures to include in the packet. Don't forget the power of networking. Encourage your existing staff to help welcome the new employee and family. The spouse might be looking for a new job, and someone in your office might know of an opening.

Catalyst, a nonprofit organization specializing in career and family issues, has published several reports and cassette programs on relocation. For more information, contact Catalyst, 250 Park Avenue South, New York, N.Y. 10003; (212) 777-8900.

Foreign Equity Markets

Where should I look to find out more about the Unlisted Securities Market of the London Stock Exchange?
O.A.A., La Habra, Calif.

Eaton Financial Management Corporation, a financial consulting company, is experienced in introducing small American firms to foreign equity markets and can give you detailed information about the Unlisted Securities Market. Contact Richard Reichter, president, P.O. Box 566, Andover, Mass.; (617) 688-5116.

Another reference is Raymond Wittig, of Lipsen, Hamberger, Whitten & Hamberger, 1725 DeSales Street, Suite 800, Washington, D.C. 20036; (202) 659-6540. His firm advises companies on going public in England through the Unlisted Securities Market. For a list of 10 United Kingdom brokers with offices in New York City that would be able to give you further information, call the British consulate in New York at (212) 752-8400.

Nonprofit Funding

I am establishing a statewide, nonprofit, tax-exempt cancer control organization and am frustrated because I cannot find a source of loan funds for such an operation. Since no profit will be generated, the business will have no investor appeal. All an investor will receive, in return for a loan, will be the accrued interest payable on the money. I will not own this organization, so I have nothing to offer as collateral. Do you know a source of loans available to nonprofit groups like mine?
A.F.S., Mason City, Iowa

For help in setting up and funding a charitable organization, you can write to the National Society of Fund Raising Executives, Richard Wilson, president, 1101 King Street, Suite 300, Alexandria, Va. 22314. You can also write to Volunteer—The National Center for Citizen Involvement, 1111 North 19th Street, Suite 500, Arlington, Va. 22209. For accreditation and support in your area you can write or visit United Way of Cerro Gordo County, Joan E. Manning, executive director, 15 First Street, N.E., No. 202, Mason City, Iowa 50401. For help in reaching other cancer organizations, you can write the American Cancer Society, 777 Park Avenue, New York, N.Y. 10001.

Zoning For Entrepreneurs

I understand there is a model zoning ordinance available that provides a new method of dealing with home-based businesses. Where can I find a copy of this document?
D.M., Syracuse, N.Y.

The National Alliance of Homebased Businesswomen has developed a package including the model ordinance and a pamphlet each for planning boards and zoning boards. The purpose of the ordinance is to promote home-based businesses, provided they do not change the residential nature of the community. To order the package, send $2.00 to the NAHB, P.O. Box 306, Midland Park, N.J. 07432.

Cost Accounting

Can you supply information for establishing a cost accounting system for a knitwear manufacturer?
B.P., Winona, Minn.

The American Apparel Manufacturers Association has literature on that subject. Contact Joan McNeal, AAMA, 1611 No. Kent Street, Arlington, Va. 22209; (703) 524-1864.

How To Ask

Have a business-related question?

Write to: Direct Line, NATION'S BUSINESS, 1615 H Street, N.W., Washington, D.C. 20062. Writers will be identified only by initials and city. Questions may be edited for space. All replies must be given in this column.

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COVER STORY

Business Outlook '86

The business outlook for the new year points to improved though moderate growth, relatively small increases in inflation and interest rates and an easing of unemployment.

Those predictions, based on an annual NATION'S BUSINESS survey of economic forecasters, set the stage for a 1986 economy that will not see anything like the recession that some forecasters had felt was inevitable this year.

But there is a strong note of caution in many forecasts because of such potential danger signals as consumer debt levels that could cut into buying, continuing problems in the farm belt and uncertainty over how critical fiscal policy decisions will be resolved in Washington.

On average, a sampling of economists surveyed see a growth rate of 3.9 percent this year, up from 2.5 percent in 1985; an inflation rate of 3.9 percent against last year's 3.3; a jobless rate at 6.7 percent, down from 7.2; and short-term interest at 7.9 percent in the year's final quarter, compared with 7.2 in the same quarter of 1985.

W. Van Bussmann, chief economist of TRW, Inc., the Cleveland-based conglomerate that makes products for the automotive, defense, electronics and consumer services markets, speaks for many of his economist colleagues when he says his company is being "cautiously optimistic" about 1986.

"The system is much more into equilibrium now than at the same time last year," Bussmann says. "We don't have excessive inventories, and we see much more balance on the international front. The rising stock market is bolstering individuals' net assets, so the consumer is not spent out."

J. Charles Partee, a member of the Federal Reserve System's Board of Governors and an authority on business cycles, sees "no clear and pressing danger of a recession" short of any major economic shocks, such as war.

A National Association of Purchasing Management survey of purchasing

Overall, business investment is expected to be flat in 1986. Capital spending for power generation equipment, however, can be expected to rise as energy consumption goes up. This steam turbine is being tested before going into service.

PHOTO: CHUCK KEELER—AFTERIMAGE

The signs point to a better year than '85, though not spectacularly so. Here is our annual survey on the prospect for inflation, interest rates, jobs, consumer buying and more.

agents in 18 industries shows most believe conditions in the first half of the new year will be better than they were over the past six months. They also provide encouraging news on inflation: Only 2 percent of those surveyed say they paid higher prices for industrial materials between October and November. It was the lowest percentage in 14 years.

Just over 25 percent report increases in orders for November, 58 percent report no change, and only 10 percent report a decline—all of which points to increased production this year.

Richard W. Rahn, vice president and chief economist of the U.S. Chamber of Commerce, takes a near-term position of "only guarded optimism." But he believes that "all the fundamentals point to further growth."

Efforts to assess the business climate for 1986 are part of a larger endeavor by economists to determine the duration of the expansion that began 38 months ago. At that point, the nation broke out of an economic bind that included runaway inflation, sky-high interest rates, the worst unemployment levels since the 1930s, and melancholy conditions in the auto and housing industries.

As the new year opens, the expansion is just a month shy of the average recovery cycle of 39 months in the post-World War II period. It has a long way to go, however, to catch up with the 106 months of the 1961-69 recovery and the 58 months of the one that began in 1975.

A sharp slowdown early last year caused some apprehension about the staying power of the current cycle. But the present expectation is for continuation of this recovery at least into 1987.

Blue Chip Economic Indicators, which develops a consensus forecast based on the views of 50 economists, projects a 3.1 percent increase this year in the gross national product—the value of all goods and services. That would be a solid improvement over the 2.5 percent rate for 1985 but substantially be-

'86 Forecasts: A Sampler

	Growth—gross national product	Inflation—Consumer Price Index	Unemployment—annual average rate	Short-term interest rates—average 4th quarter
Blue Chip Economic Indicators average of 50 forecasts	3.1%	3.7%	7.1%	7.5%
National Bureau of Economic Research average of 28 forecasts	2.7%	4.1%	7.2%	7.7%
H. C. Wainwright & Company, Economics	6.0%	NA	NA	7.6%[1]
Harris Bank & Trust Company	4.7%	3.7%	6.5%	7.8%
Kemper Financial Services	3.8%	4.6%	6.4%	8.1%[2]
U.S. Chamber of Commerce	3.7%	3.4%	6.9%	6.4%
Security Pacific Bank	3.5%	4.0%	7.0%[3]	10.5%
Average	3.9%	3.9%	6.7%	7.9%
Estimates for 1985	2.5%	3.3%	7.2%	7.2%

[1] Annual average rate
[2] Commercial paper rate average 2d and 3d quarters
[3] Average 4th quarter '86

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COVER STORY

Business Outlook '86

David D. Hale, chief economist of Chicago-based Kemper Financial Services, says the level of consumer spending is the key to the economy next year.

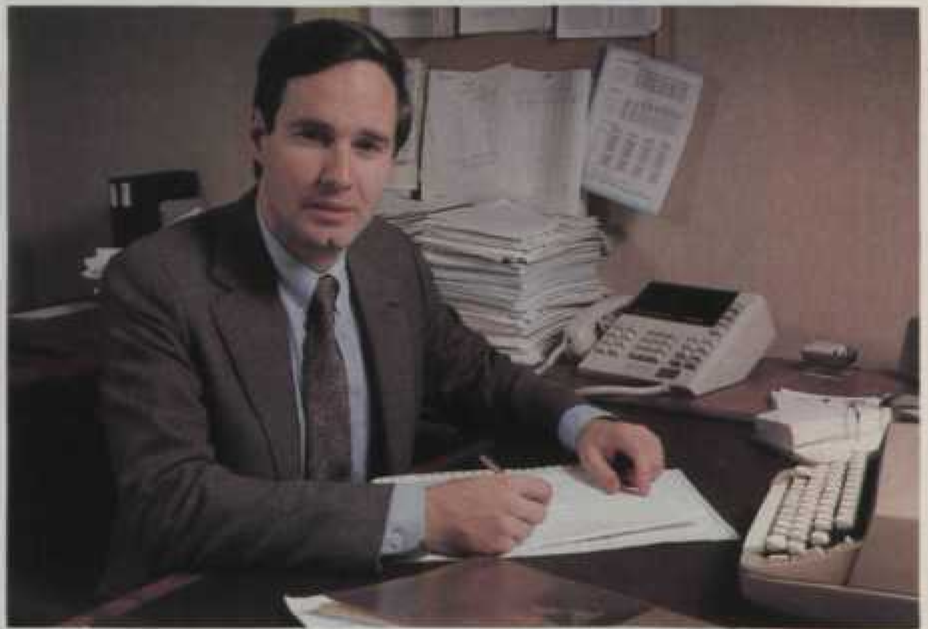


PHOTO: TERRY LEE—BLACK STAR

low the sizzling 6.8 percent of 1984, peak year for the current expansion.

The National Bureau of Economic Research and the American Statistical Association obtained an average of 2.7 percent growth in 1986 when they surveyed 28 economists at banks, corporations, consulting firms and academic institutions. Those economists also expect 4.1 percent inflation and unemployment at last year's rate of 7.2 percent.

One of the most optimistic growth forecasts comes from H.C. Wainright & Company, Economics, a financial advisory firm based in Boston. It expects a 6 percent growth rate in GNP, and it is telling clients to expect a strong cyclical upturn in housing construction and car and truck production.

The roaring bull market in Wall Street in the closing weeks of 1985 was seen as strong evidence that the economy would remain generally healthy in the new year. Kenneth N. Carauana, research director for the regional brokerage firm of Prescott, Ball & Turben, says, "There is an anticipation that this business cycle will extend itself into 1987. The decline of the dollar is helping this situation."

He says the turning point for investors was the intervention in the international currency markets by major trading nations including the United States in September, and the resulting 8 percent fall in the dollar's value against other countries' currencies. "That signaled the end of a two-year period of deflationary policies at the Federal Reserve Board," Carauana says. In a related action, the Fed adopted an easier money policy, he points out. Carauana predicts that, "as long as we have an easy money policy, stocks will move upward."

But there is also a lot of cautionary advice about how businesses should operate in the new year.

Rosalind Wells, chief economist for J.C. Penney Company, advises business people: "Consumer spending is going to be slow. Play it cautious. Keep a close watch on inventories." General Electric Company expects 1986 to be "flat" through the first three quarters or beyond, with recovery from last year's slowdown not occurring until late in the year or even early in 1987.

A downright pessimistic outlook comes from the Monetary Policy Forum, which is made up of economists who believe interest rate levels are a prime determinant of economic activity. It expects less GNP growth—a bare 2 percent—in 1986 than in 1985.

Lawrence Chimerine, who is president of the forum and also heads Chase Econometrics, of Philadelphia, says there are good reasons for that bearish outlook. Consumers already have too much outstanding debt and cannot be counted on to spur the economy further, Chimerine says, and businesses have grown accustomed to operating with lean inventories, which has put a damper on factory production. In turn, he adds, the fact that there is so much unused factory capacity dissuades businesses from investing in new facilities.

The Federal Reserve's Partee is more optimistic. He lists five indicators that can signal a downturn and says three are showing surprising health. They are the inflation rate, interest rates and the ratio of inventory to sales.

Partee says inflation is under control, and interest rates are steady— the opposite of what usually occurs when an economic expansion reaches the stage of maturity. He says the low inventory/sales ratio raises the prospect that retailers will be increasing orders to factories.

He acknowledges the concern that sharply reduced consumer spending might prove a threat to the economy in 1986, particularly in durable goods—by economists' definition, those that last more than three years. Demand for autos, furniture and other big-ticket items built up during the recession of the early 1980s and may have been worked off during the current expansion, Partee says. But he insists the overall signs are for increases in employment, personal income and spending in the new year.

Low inventory levels could mean replenishment orders that will expand factory production and put more people to work, Partee says. Another factor that he sees in his optimistic outlook for consumer spending is the prospect that the declining dollar will help industries that had curtailed production in the face of stiff foreign competition. The strong dollar made imported goods less costly in this country.

The fifth indicator of potential trouble, excessive speculation in financial assets, is the most worrisome to Federal Reserve Governor Partee. He says that corporations are piling up debt at a pace not seen since the 1920s, using the money for mergers, acquisitions and leveraged buyouts, among other purposes.

If an economic slowdown curbed the cash flow needed to pay off that debt, Partee says, the resulting problems could have broad economic consequences.

The durability of consumer purchasing power also concerns David D. Hale, chief economist at Kemper Financial Services, of Chicago. When it comes to growth in the new year, he says, "the big unknown is timing. When will consumers' incomes grow enough to sustain a higher level of purchases?" He says that will happen as factory production rises in response to inventory rebuilding. Increased production will lead to more employment and more pay.

J. Charles Partee, a Federal Reserve Board governor, says there is little risk of a recession in 1986. He is concerned, though, about the amount of debt used in today's economy.

PHOTO: T. MICHAEL KEZA

Hale also believes that an improving trade balance will help generate more consumer buying power as import levels stop rising, U.S.-made goods become more competitive, and exports increase.

His optimism is shared by a fellow Chicagoan, Robert J. Genetski, chief economist for the Harris Bank & Trust Company, who expects a 4.7 percent growth in GNP this year. He bases his outlook on continued low inflation—he expects a rate of 3.7 percent—and lower long-term interest rates.

There are mixed views on how much progress is being made to resolve the problems caused by the strong dollar. Though the dollar has dropped 20 percent against the Japanese yen and 10 percent against the German mark since September, Chimerine says there could be a lag of 6 to 12 months before the drop results in rising orders for U.S. goods.

Though such concerns as trade, inflation, interest rates and unemployment are basic building blocks of economic forecasting, there is also the vital question of the effect of actions by the federal government in a given year.

This new year is developing as a particularly critical one from the perspective of the impact Washington decisions will have on the business climate.

U.S. Chamber economist Rahn may expect a 1986 rebound from last year, but he also says: "The major risks to our scenario for continued expansion stem from fiscal policy considerations."

The principal areas of government activity that concern most economists about the 1986 business environment are spending, tax and trade policies. Their questions deal with whether Congress will curb spending or raise taxes to reduce the federal deficit, whether any tax "reform" legislation eventually passed will be anti-investment and stunt growth, and whether the massive trade deficit can be cut in a way that furthers global trade by U.S. companies.

There is an underlying sense of optimism in many business quarters that those major issues will be resolved in a way that does not worsen the business climate.

One reason for the optimism is the perception that President Reagan's personal popularity gives him a far stronger base than his congressional opponents in the battle over fiscal restraint. That was evident when the Capitol Hill fight over the Gramm-Rudman-Hollings deficit reduction bill focused primarily on the extent of exemptions, not on the main goal of reducing and eliminating red-ink budgeting. The Gramm-Rudman-Hollings plan was the catalyst for a sea change in Congress: The majority sentiment there now is that it has become politically unwise to be seen as an opponent of cutting the deficit.

But that does not automatically translate into laws mandating fiscal restraint. It offers a potential for a guns-or-butter stalemate, with some members insisting on cuts in social programs and others demanding curbs of the military budget. Congress will have to meet the question head-on this year.

President Reagan's new budget director, James C. Miller, says the fiscal 1987 budget that the President sends to Congress next month will call for a deficit of no more than $144 billion, compared with the $195 billion expected in the fiscal year ending this September 30.

But, Miller concedes, "it won't be easy" to win congressional approval for the program cutbacks needed to reach the lower deficit figure. The White House targets, he says, will include "middle-class and upper middle-class subsidies, and there is a lot of pork out there to go after."

How far that strategy will get in a congressional election year remains to be seen. The White House track record does not offer much comfort. Congress agreed to eliminate only one of 20 federal programs President Reagan wanted to kill last year, and it even delayed termination of that one—federal revenue sharing with state and local governments—for a year beyond the cutoff point recommended by the President.

Experts in the art of the possible in Washington say that Reagan's determination to continue the military buildup while cutting the deficit will force him to concentrate his spending reduction proposals on a wide range of nondefense programs that have strong political constituencies. If he fails with that strategy, business organizations fear, pressure for cutting deficits via tax increases are sure to grow. They believe that any such increases would likely fall heaviest on business.

Treasury Secretary James A. Baker, who is chairman of the cabinet-level Economic Policy Council, says that getting federal spending under control is the keystone to President Reagan's overall economic policy.

With the administration planning on seeking real growth of 3 percent in the military budget, Baker acknowledges there is some risk of higher taxes.

Business sees a more immediate threat, however, in the prospect of a tax increase that could total $140 billion over five years. The massive "reform" package the House Ways and Means Committee drafted would shift an additional tax burden of that magnitude to business to offset reductions in individual taxes. The fate of the package remains very much in doubt, however.

Business had long supported the concept of tax simplification. But major

COVER STORY

Business Outlook '86

business organizations backed away from the current legislative effort when it became apparent that the House tax-writing committee was patching together a plan that would drastically roll back incentives for growth and investment. Those incentives, passed in 1981, have been given major credit for the economic expansion of the past 38 months.

On tax reform as well as spending, business is looking to President Reagan to stand in the way of anything that would do major damage to the climate for economic growth. There had been extensive speculation in Washington that he might endorse the House bill, without reservations, as the only way to keep up momentum on tax reform. But he did not do so.

The President said that the House bill represented no more than a start on tax reform and was not an end product. He addressed business concerns specifically in stating that he would not accept as tax reform any legislation that "ends up retarding economic growth." He called for provisions that would, among other things, "strengthen economic growth and personal opportunity for every American."

Baker, noting that the House Ways and Means Committee is dominated 2-to-1 by Democrats, and that a revenue measure "is a five-step process going through two committees, two houses, and ultimately, a joint Senate-House conference," told NATION'S BUSINESS: "It really is premature to make a determination as to what the final product might be."

Reagan's statements on growth were viewed as a positive sign for 1986 because they served notice that he would not accept antibusiness tax changes simply to achieve his goal of a simplified system.

Key business concerns, as the tax reform debate moves into 1986, are proposals to eliminate tax credits on new investment and to sharply limit depreciation allowances for expenditures on equipment.

The Ways and Means proposals may already have triggered adverse economic consequences because businesses perceived them as a threat. The prospect of higher taxes affected many investment decisions in the latter half of 1985, and Commerce Secretary Malcolm Baldrige says current estimates are for no real growth in capital spending by business this year. Such spending was up 15 percent in both 1983 and

PHOTO: T. MICHAEL KEZA

Treasury Secretary James A. Baker is the Reagan administration's chief economic policymaker. He says the two highest priorities are cutting federal spending and tax reform.

1984, but only 6 percent last year. It could recover this year if the threat to revise investment and depreciation rules eases.

"Now is not the time to reduce incentives to invest in productivity-enhancing equipment," Baldrige told NATION'S BUSINESS. "It is no time to favor consumer spending over investment."

Because of the uncertainty caused by the year-long discussion of various tax reform proposals, some major business organizations and companies are calling for a moratorium on action in that area. They are urging the administration to concentrate on curtailing spending as the most effective contribution that could be made to economic health in the near term. The organizations include the U.S. Chamber of Commerce, the Business Roundtable and the National Association of Manufacturers.

Some other business organizations and companies remain committed to tax reform along the lines proposed by the Ways and Means Committee, because, they believe, the advantages outnumber the disadvantages. The bill's threats to investment are of less concern to industries that are not capital-intensive.

In addition to the debate on spending and tax policies, a third area in which government actions can have a major impact is international trade.

Since the United States joined in September with its major trading partners to intervene in international currency markets, the dollar's decline has muffled protectionist cries somewhat. Growth, interest and inflation rates in the United States, Japan and West Germany are converging, and the stage is being set for closer coordination of economic policies by the world's three dominant trading powers.

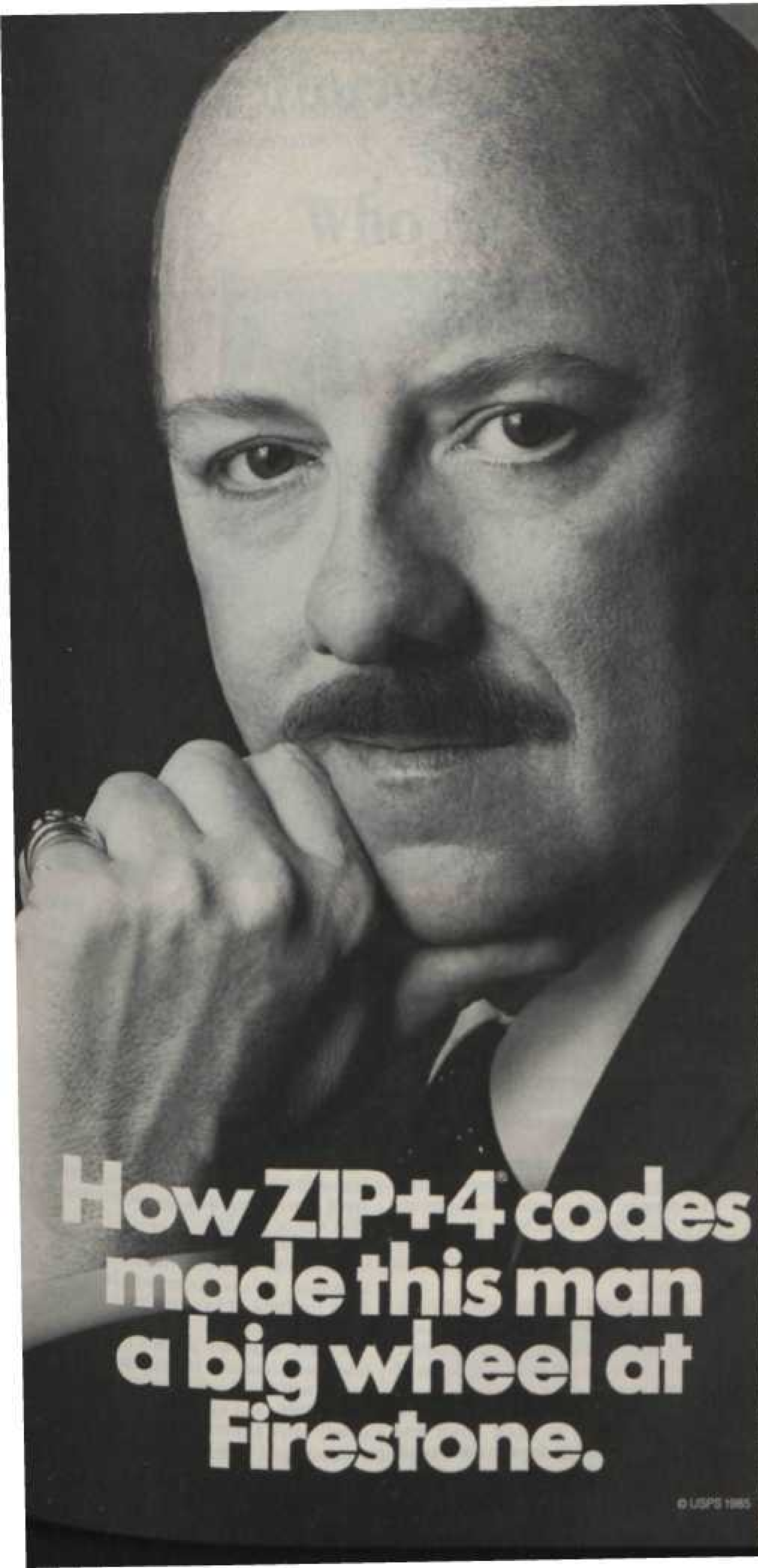
The administration is also considering revisions of antitrust laws as another step toward improving the U.S. trade performance. Baldrige says the present prohibition against domestic mergers that "may tend" to decrease competition is vague and can prevent effective action by American industries faced with tough competition from abroad.

He offers as an example of possible change a provision that would grant a five-year partial exemption from antitrust laws to such industries so they could better compete with foreign companies.

This action on antitrust laws would fit into a broad administration strategy to deal with import problems in a manner that puts U.S. firms and their rivals from abroad on a level playing field—and heads off protectionist drives in Congress. The administration has insisted that limiting imports to help U.S. industries would backfire in the long run because affected nations would retaliate against American products.

Overall, the Washington actions will be part of a broad mix of developments in both the public and private sectors that will determine the course of the economy in 1986. As Malcolm Baldrige puts it: "It is within our power to have a continued expansion."

—Peter A. Holmes



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COVER STORY

Business Outlook '86

The giants continue to bend—but not break—under economic pressure.

Heavy Industries: Hopeful Mix

The sustained recovery in car and truck sales will continue in 1986, according to industry spokesmen, but the boom offers little solace to embattled metals and chemical industries.

The U.S. industrial scene is offering a mixed bag of predictions for 1986. Depending on the field, and depending on whom you talk to, the answers are maybe good, maybe bad. The automotive industry, for example, seems to be showing the most differences of opinion at the top of its ranks.

The sustained recovery in car and truck sales will continue in 1986, according to industry spokesmen, but the boom offers little solace to embattled metals and chemical industries, which look to the weakening dollar for relief from slumps.

Roger Smith, chairman of General Motors, told NATION'S BUSINESS that vehicle sales in the United States will again total about 15 million in 1986, but he hedges.

As of mid-December, 1985 sales were running at annual rates of about 11 million cars and 4.7 million trucks. For cars, that would make 1985 the best year since 1978, when sales totaled 11.3 million. Imports account for 25 percent of current car sales, however, compared with less than 18 percent then.

Ford Chairman Donald Peterson disagrees with Smith and predicts that 1986 sales will fall to 10.4 million cars and 4.4 million trucks.

"I think part of the reason we got as high as we did in 1985 is that we were still recovering from extremely low levels," Peterson says, "so we were way outperforming the economy in the first half of the year especially. And perhaps we had abnormally high sales during those extraordinary finance programs in the latter part of the year."

The big question concerning 1986, Peterson says, will be "the dynamics of imports. You have to assume it is a thrust that is pushing for even more volume."

The U.S. government relaxed its restraints on auto imports last April, leading to a spurt in sales of imports, 80 percent of which come from Japan.

The current trend toward bigger, more profitable cars will partially offset the expected lower volume for 1986.

PHOTO: ANDY SACKS

Although not a beneficiary of the bigger-car trend, Chrysler boosted sales by almost 17 percent in 1985.

Chrysler Chairman Lee Iaccoca says the next six months "will be all right. Our stocks are in good shape, cars should be hot, fleet orders are very strong. "I'd be kidding, though, if I said I felt we could carry this prosperity of the last couple of years on a continuing basis with all the problems that are looming."

The chemical industry—beset for years by the strong dollar, weak industrial demand and competition from imports, and more recently by an agricultural slump—is in the midst of a massive restructuring that will continue in 1986.

Union Carbide, for example, plans to buy back 14 percent of its own shares. Olin is selling unprofitable operations. DuPont plans to cut back still more of its work force.

Dow Chemical Company reflects the industry's efforts to scale down and shift emphasis away from cyclical products and toward growing, more stable, markets. During the past four years, Dow has reduced its payroll by 9,000 workers, written off $900 million in assets and sold $1.5 billion in operations that did not contribute to its long-term objectives. Meanwhile, Dow has also expanded in pharmaceutical and specialty chemical operations.

The falling value of the dollar offers some encouragement, since Dow does 55 percent of its business in foreign currencies.

The steel industry, burdened by overcapacity, still is looking for its recovery. After four straight money-losing years steel executives are wondering if 1986 will be the fifth.

Steel consumption fell 3 million tons in 1985, and may fall further in 1986, according to the American Iron and Steel Institute. It has also been a victim of the high dollar.

Market watchers predict that nickel prices will continue to languish, copper prices will dip further before recovering in 1986, and aluminum will remain steady after a recent rise.

—*Bernie Shellum*

Section continues on page 58.

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MANAGING YOUR BUSINESS

Making Sure Your Business Outlasts You

By Sharon Nelton

Television viewers know her as the mother of Kate Jackson in "Scarecrow and Mrs. King," and many remember her as Fred MacMurray's wife on the long-running series, "My Three Sons." In real life, Beverly Garland *is* a wife and a mother.

She is also an entrepreneur, and she shares a goal common to America's estimated 13 million family business owners: keeping the business in the family.

Most entrepreneurs dream of turning control of a business over to a daughter or son who will run it with the same love and attention. But sometimes children either do not want, or are unable, to run the business. Then, to keep ownership in the family, alternatives—such as hiring professional managers—must be found.

Desire to pass a family enterprise on to the next generation may be strong, even passionate. But even in the most harmonious of families, making the transition is not easy.

"The concept of 'smooth succession' is an oxymoron [contradiction in terms]," observes Peter Davis, Director of executive education at the University of Pennsylvania's Wharton School. Davis says that succession in a family business "is probably the most complex management challenge anybody faces." Not only is it a highly charged emotional issue, but it often requires changes in the structure and culture of an organization as well as changes in the people involved.

One thing that might make the process easier for Garland and her partner, husband Fillmore Crank, is that they began early to take steps to attract their children to their business and prepare them to take over.

Despite more than 200 film and TV roles, Garland found out long ago that being an actress does not always mean steady work, and she wanted a hedge against down times in her career. She and Crank, a general contractor, decided to go into the hotel business, building the 262-room "Beverly Garland's Howard Johnson's Resort Lodge" in North Hollywood, Calif., in 1973.

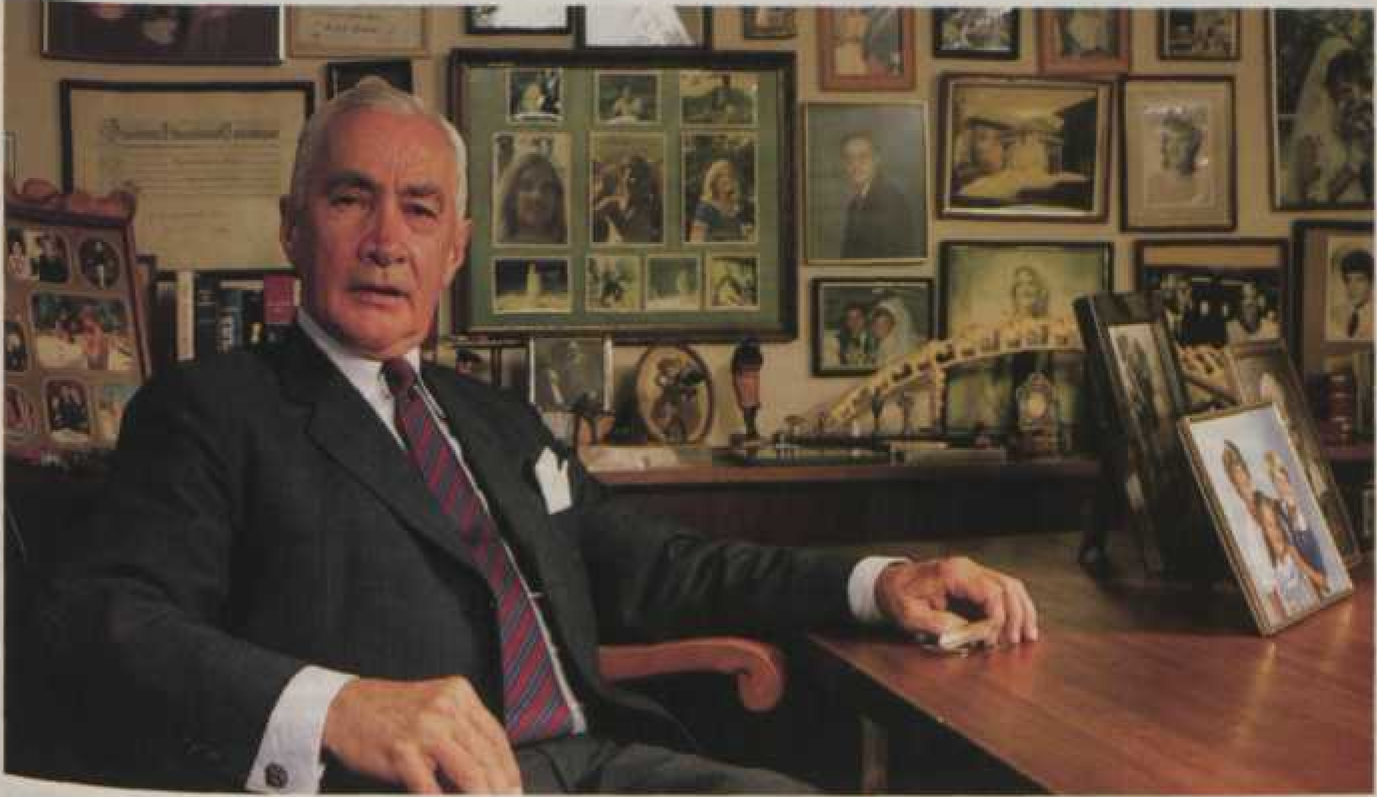
Crank was a widower with a teen-age son, Fillmore, Jr., and daughter, Cathleen, when he and Garland married. They have a daughter and son—Carrington, now 21, and James, 17.

Beverly Garland and her husband, Fillmore Crank, Sr., (right) want to make sure their hotel business can be smoothly passed to their four children. They designed a plan that would reward their eldest, Fillmore Crank, Jr., (center) for his experience and dedication to the business, and still protect the others.

PHOTOS: T. MICHAEL KEZA

Grooming your heirs to the family business can end up in snarls. But these can be overcome with understanding and careful advance planning.

Through his work at the Center for Family Business in Cleveland, Léon Danco has witnessed numerous tragedies, including estrangement, lawsuits and business failures, because family enterprises were passed on with poor planning or to the wrong relatives.



Fillmore, Jr., returned from Vietnam when the hotel was nearing completion, and Garland and Crank put him to work as manager. Garland says there have been times when, short on help, she has done the hotel laundry herself, and Crank has cleaned the rooms and made beds. "We're the kind of people that if something has to be done, you just pitch in and do it," she says.

The family business expanded to a second hotel in Sacramento. Young Fillmore oversaw its construction and has been manager of the 207-room facility for five years. Cathleen, who had been housekeeper of the Howard Johnson's, took over as manager of that hotel until she left to have a baby.

Garland's and Crank's hotels now do $9.4 million worth of business a year and keep 300 people employed. Crank is 64, and Garland is in her mid 50s. And, as Cleveland family business consultant Léon Danco would bluntly remind them, they aren't going to live forever: "Although we might like to believe we are divine, we cannot live out the ultimate myth, our own immortality."

As family businesses go, the situation that Garland and Crank find themselves in is a common one. Like other business owners, they must plan a transition of ownership, management and wealth—or it will be done for them by courts and heirs after they die.

One issue they are considering is fairness. Fillmore, Jr., 37, is the only member of the second generation deeply involved in the business and the one most clearly prepared to take over. To provide him with an incentive besides salary, Garland and Crank have begun, in the last year, to transfer interest in the company to him under a tax provision that permits each to give him $10,000 a year tax-free.

With continued planning—and luck—Garland and Crank may be able to avoid the heartbreaking rifts so many families go through when a new generation takes over. Danco recalls a daughter-in-law who, on learning that her husband was not to be his father's successor, told her father-in-law that he would never see his grandchildren again.

For more than 20 years, Danco's Center for Family Business in Cleveland has been running seminars to help families deal with the many highly charged issues centered in their businesses.

A seminar on managing succession in November drew more than 100 participants from 33 companies. Some were founders and spouses who had attended a Danco meeting before and now had grown children in tow. Others came in droves as families, bringing as many as 9 or 10 members. Still others reported

Founder Stew Leonard, Sr., (second from right) has had trouble loosening his grip on the everyday activities of his dairy store. Now he works on creative, long-range planning and can delegate more to his children, Tom (left), Beth and Stew, Jr. (far right).

PHOTO: T. MICHAEL KEZA

being unable to persuade a reluctant parent to come.

The meeting room was filled with concerns, some stated openly, others admitted quietly over dinner. Sons expressed fears that their fathers would never retire. Daughters and wives spoke of men who would not let them share in running the business. One young woman said she had been disowned because of business differences with her parents. A son-in-law, the obvious successor in one business, said he did not wish to inherit family problems with the business. "I don't want to be the savior of my wife's family," he said.

Although the seminar did not directly help families solve the burning emotional issues, it did help them get some of the issues out in the open. And it covered such topics as getting the company organized for succession and ownership transfer techniques.

Successful transition is not just a concern of the families themselves. Obviously, employees have a stake in seeing the business continue and prosper. But so do large corporations and entire industries. Franchise stores and distributorships are frequently family owned, and corporations that depend on them are concerned about the stability of the families involved.

Almost all the 800 Allied Van Lines agencies across the country, each doing anywhere from $100,000 to $25 million in business annually, are family owned, according to Allied training specialist Mary England. (Allied is not a franchisor—all stock in the corporation is owned by the agencies.)

"Right now a large percentage of our agencies are going through succession," England says. "If a smooth transition doesn't take place in ownership, and the next generation hasn't been prepared for the business, at the worst, that agency would go bankrupt and Allied would possibly no longer be represented in that market. At the other extreme, maybe the agency would no longer grow, which once again hurts everyone involved."

Allied already offers accounting help for families going through succession, and England is developing a broader program aimed at helping agencies make a successful transition.

Succession in a family business is a two-part equation, according to the Wharton School's Peter Davis. One part consists of the founder or owner letting go and turning the company over to a successor. The other consists of the potential successors developing themselves to take over.

Davis says planning a succession takes at least five years. The process should begin by the time the entrepreneur is in his or her mid 50s, with the children possibly in their mid 20s. Here are some guidelines for both parents and children, as suggested by consultants, educators and members of family businesses themselves:

Parents

• Look at how you can alter your relationship to the company so that you are not so central to it and it is not so dependent on you. Stew Leonard, Jr., notes that his father used to come into his Norwalk, Conn., supermarket, Stew Leonard's, every day. Now he is delegating more and coming into the business less often.

"We are in here, putting out the daily and weekly fires, while he is getting more strategic, starting to think down the road five years rather than worrying that the windows are not clean in front of his building," says young Leonard.

• Develop an organization chart and put it on paper for all to see. This is part of delegating and structuring the organization so that you can learn to let go. "The business has to be more than you," says Davis. You must "institutionalize" it so that there is something to hand over when the time comes. Your organization chart should include key nonfamily members as well as family members.

• Plan for more than one successor. It is too risky to depend on just one potential heir to the throne—he or she might be run over by a truck or suffer a debilitating illness.

• Let everyone know where they stand. It should not come as a bitter surprise to someone who is ultimately not chosen. Career alternatives need to be discussed with those who are not going to be successors. Malcolm (Mac) Donley, 30, of Donley's, a Cleveland construction firm, says that while it is his goal to succeed his father as head of the company, he knows he is not the only contender. "There are other good people here. I have to be just as good and maybe better than they are to get that position."

When Dorothy Roberts (center), president of Echo Design Group, Inc., recognized wanderlust in son Steven (left), she suggested that he leave the company and travel. After earning an M.B.A. in France, he is back at Echo with his mother and sister, Lynn (right).

PHOTO: WAYNE SORCE

• Have a clear personal development program for your potential successors. Teach them all you know, and support their efforts to develop themselves.

• Encourage your successor to get worthwhile experience outside your business. And don't fret if your offspring wants to leave the company for a while. Experience outside the family enterprise will bring back fresh perspective and head off any concerns that the heir might wonder later "what it's like out there."

Dorothy Roberts, who succeeded her first husband as president of Echo Design Group, Inc., a New York fashion accessories company, says that her son Steven felt obligated to come into the firm when his father died. "I don't think he intended to come into the business," says Roberts. He worked for two years, but, she says, "I knew he really still had that wanderlust and wanted to get out and travel and explore other areas." She suggested that he take a sabbatical, which he used to work on an M.B.A. in France.

"I did it because I felt that I owed it to him, but I also did it because I think when a son or daughter of an owner works in a business, they have to love that business and want to be there." Steven, 29, is back in the company as vice president of sales, and his sister, Lynn, 32, is in charge of advertising and publicity.

• Don't neglect your daughters. In a study on family businesses, Paul C. Rosenblatt and a team of University of Minnesota researchers found that most entrepreneurs preferred passing a business on to nonrelatives instead of a daughter. But when they don't give daughters a chance, entrepreneurs lose 50 percent of potential offspring successors, Rosenblatt says in a book called *The Family in Business* (Jossey-Bass). "If one would like to pass a business on to a blood relative, and one wants to maximize one's chances of finding somebody willing and competent, it seems self-defeating, even if one has sons, to fail to consider daughters."

• Develop personal interests so that you have something to retire *to*. Going to Florida to sail and play golf is not enough, warns Davis. Entrepreneurs who do that "get bored, and they come back and get into mischief."

Consider, instead, spinning off part of your existing business and starting a new business.

Or, suggests Davis, use the opportunity to "re-energize" your creative talents. He describes the founder of a machinery company whose 33-year-old son said, "Either I take over now, or I leave." The father did not want to lose the son—he was too valuable. So the father handed over control to the son and started a consulting firm in design engineering, the creative work he had done in the beginning. And the company he had turned over to his son became his sole contractor.

• Make sure you and your spouse have enough income once you retire. (See related article, page 40.)

• Keep your plans up to date. Reading, Pa., management consultants Patricia and Edward Langiotti say they are working with a particularly tricky situation. A family in a retail business is facing a third generation transfer where, because of succession agreements made by the partners, the business could fall into sole ownership of uninvolved family members. A cousin has made a career out of running the business and does not know, because the family has kept it secret, that he may end up out in the cold.

The Langiottis have the task of helping the partners see that the agreement they drew up long ago, providing that the living partner would buy out the deceased partner's share, is not only unfair but out of date. It does not take into account the way the offspring in the third generation have developed and what their interests are.

Children

• If you are interested in having a role in the family business, make it known. Discuss your goals with your parents so they, with appropriate educational and development steps, can support you in achieving them. If a parent wants you in the business but is reluctant to delegate real responsibility so that you can get the necessary experience, the Langiottis suggest you get tough and insist on an employment agreement.

It could set forth the fact that you are making the company your career choice with the goal of eventually owning and managing it. The agreement should then set up a series of accomplishments that can yield more and more of a management decision-making role as you show, through your perfor-

mance, that you can handle this level of responsibility. It should also include a plan for distribution of stock to you or some kind of profit sharing that ensures that you reap the benefit of your work.

- Take responsibility for your development. Davis says you must first go through an apprentice phase, where you learn something about the business. Then you need to specialize, getting a specific skill under your belt. It could be accounting, finance or sales, for example, and it will give you something to fall back on "if the old man sells the business." Finally, you must become a generalist, learning to manage.

"Those stages need to be planned, they need to have goals at each step along the way, and they need to be evaluated," says Davis. You also should be under the supervision of someone other than your parents.

- Get a mentor. Again, says Davis, this should not be the parent—he or she has too many roles to play with you. You need somebody who can give you support throughout the development process, says Davis, "preferably a respected, experienced outside person who can counsel you and give you the advice you need on your longer term career development skills."

- Get experience outside the firm. This not only helps you gain self-confidence, knowledge and new ideas, but it often enhances your credibility with employees in the family business, who know you "made it" somewhere else.

A few last words to parents:

Give your children room to make mistakes, but find the right balance between coming down too hard on them just because they are your children and overlooking their errors. Be as fair with them as you would with a nonfamily employee.

"Entrepreneurs somehow expect their children to have the management skills that the parents took 20 years to develop, and the willingness to sacrifice financial rewards for many years, and the willingness to work the 12-hour days that they did when they were starting up," says Sharp Lannom, president of DeLong Sportswear in Grinnell, Iowa.

"None of those things do they expect from somebody from the outside."

Lannom, 47, went into the family business 25 years ago when his father died and his mother and three younger brothers needed his help. He had intended to pursue a different career, partly because, like many children of

The Family That Works Together

Mornings were pitch black when, between 4 and 6 o'clock, a milk truck driver from the family dairy would pick up Stew Leonard, Jr., and his kid brother Tom. Stew was only 10 or 12 years old at the time, he remembers.

First they would go and have breakfast at the all-night doughnut shop, where all the milk and bread deliverymen met. Rubbing elbows with them made him feel "like a king," says Stew. "They were big shots."

Then, filled with excitement, the boys would go out in the dark, Stew with one driver, Tom with another, and deliver milk to people's homes. And, says Stew, "The drivers liked it because they would run off one side of the truck and we would run off on the other side with our little carriers of milk, so that we would deliver both sides of the street at the same time."

That memory is one of many that enticed Stew, Tom and sister Beth into what has become Stew Leonard's, billed as "The World's Largest Dairy Store," a nationally known $80 million-a-year supermarket still run by Stew Leonard, Sr., in Norwalk, Conn. And it is one of the stories Stew tells when he is asked how his father made the family business attractive to him.

Family business consultant Léon Danco of Cleveland enjoys describing how the typical entrepreneur poisons his family against the business. "He has a day when everything goes wrong. The government is no damn good, the help won't cooperate, the suppliers won't give credit, the customers won't pay, the competitors play unfairly, the taxes are outrageous. . .and then he puts his arm around his kid and says, 'And someday, Son, this will all be yours!' Then Dad wonders why his son goes into the Peace Corps or becomes a violinist."

He reminds entrepreneurs that they must share the joys of their businesses with their children as well as the woes, or they will get no takers when they want to pass the enterprise on to the next generation.

The Wharton School's Peter Davis says an entrepreneur has to share both the "magic" of the business and his knowledge and skills with the child. Mere exposure, such as plant visits or odd jobs that are only time fillers, he says, are "not that much of a learning experience." The parent has to "put it all in context and explain what's key and what's not key."

Dorothy Roberts, president of Echo Design Group, Inc., a $20 million-a-year fashion accessories company in New York, recalls that as a teen-ager, one of her jobs was to keep customer cards up to date. While filling out such cards might be a boring job for someone else, Roberts found it exciting. She says she could see which stores were buying the most from Echo and she could also see how her family's business was growing.

"My father started bringing me to his place of business in lower Manhattan when I was 8 or 9 years old," recalls William Dorman, 55, executive vice president of N. Dorman & Company, a Syosset, N.Y., cheese company. The family was living in Brooklyn then and going into the city was a big event.

Dorman and his older brother, Avram, now president of the $125-million-a-year company, cleaned the refrigerator and made corrugated cartons. They also "cleaned" Muenster cheese, removing its wrapping, scraping off the fatty oil that had collected on the surface and rewrapping it. "It was a terrible job," Dorman says with a laugh. The cheese smelled and was greasy.

But the job was not make-work. It was something that had to be done.

"It made me feel that I was contributing," says Dorman. "In my own little way, I thought that I was doing something worthwhile. I was happy to be part of the business." He adored his family's enterprise from the start and never thought of doing anything else.

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Making Sure Your Business Outlasts You

Sharp Lannom (right) took over DeLong Sportswear at age 22 after his father died. His brother, Bill (left), is vice president of sales and marketing.

PHOTO: T. MICHAEL KEZA

business owners, he found it hard to work with his father.

Parents should take their children into the family business only if they really enjoy it, counsels Ralph E. Stinson, chairman of Bettcher Manufacturing Corporation, a Cleveland metal stamping firm.

"To come into the business because someone else wants you to be there would be something like a prison sentence," he says.

Stinson's son, David, is Bettcher's vice president of manufacturing and a likely successor.

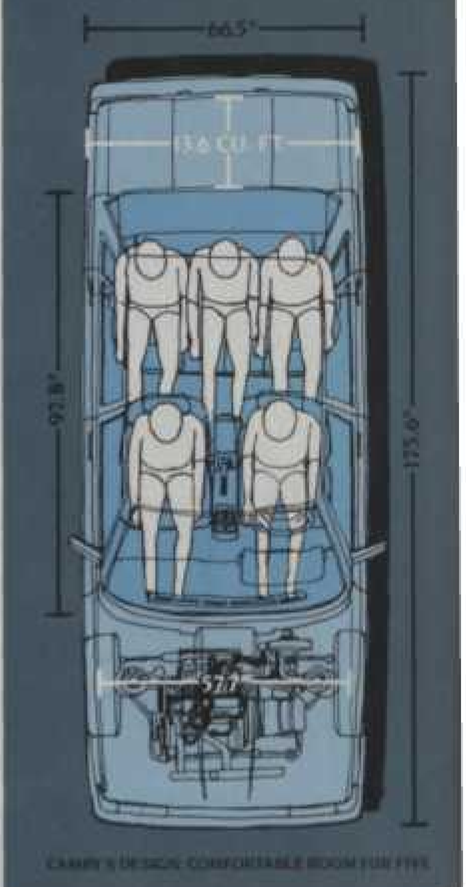
Agree on clearly defined responsibility, suggests Pat Langiotti, "so that you don't have the younger person thinking he has authority that Dad is yanking out all the time. That's something we see over and over."

Tom Kilpatrick, 27, expects to succeed his 65-year-old father as head of the Kilpatrick Investment Company in Oklahoma City. Tom has delayed marriage to devote himself to the business and learn as much as he can over the next few years. "Out of respect for that," he says, "I would like to have my father consider me not as a kid climbing the ropes but more as a partner and teammate."

Ultimately, experts caution, you must be honest with yourself about a child's ability. If he hasn't got what it takes, he can still own the company, but management should be turned over to a nonfamily professional.

"How do you get a family business to last 200 years?" asks Philadelphia consultant James E. Barrett. "You never put it in the hands of an incompetent kid just because you love him!" ■

To order reprints of this article, see page 85.



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Circle No. 21 on Reader Service Card.

MANAGING YOUR BUSINESS

A Financial Guide To Turning Over The Helm

By Irving L. Blackman

The typical closely held corporation was started on a shoestring by one person who worked long hours for little or no pay, passed up vacations and had little time for interests outside the company.

Now he wants to slow down. The firm is running well, and there is no reason why he can't travel or pursue hobbies and other leisure time activities he has neglected.

Maybe he is worried about his health, or he fears that advancing age will prevent him from keeping up the pace required for his company's continued growth. Whatever the reason, he has joined the many business people who must decide when and how to transfer ownership or control of the firms they founded.

Facing this decision can be traumatic if you can't conceive of your business running successfully without you. But it is going to run without you sooner or later, whether or not you want it to. You can delay the transfer of power, but you can't prevent it.

Providing for continuation of the business should, of course, be a key factor in normal planning. But it is a matter that is ignored, or done improperly, in too many companies. Consultants continually receive pleas for help in resolving problems resulting from:

- Delays in developing a workable business transfer plan because the founder can't decide which family member should run the company, what positions others should have, how stock should be allocated among members of the family, and what the best mechanism is for transferring the stock. If the business continues to grow during this period of indecision, the tax impact of the transfer intensifies, and the problem is compounded.
- Poorly planned transfers, which bring the owner or family members up against a sudden realization that they have incurred heavy tax liabilities.
- Garden-variety procrastination.

Irving L. Blackman is a senior tax partner of Blackman, Kallick & Company, Ltd., a Chicago-based accounting firm specializing in closely held businesses and publisher of Transfer Your Corporation to the Next Generation . . . Tax-Free.

ILLUSTRATIONS: WILLIAM COULTER

Development of an effective, timely transfer plan can, at first, seem an overwhelming challenge. The questions rush in: Should I sell my business to my children? Give it to them? All of it? Part of it? Should I give up management but keep control? Who should hold majority ownership while I am still alive? After my death? What will a transfer's tax impact be on the children? On myself?

There have to be questions, of course. They are the basis for beginning to prepare an orderly transfer plan. But they must identify the plan's objectives. The owner contemplating a transfer should ask:

1. Who will operate the business after I retire? Is a competent family member or employee ready now? Should an outsider be considered?

2. How will I maintain income for myself, my wife and any other remaining dependents after my retirement? Will it be through dividends or payments from an established pension or profit-sharing plan? Should such a plan or plans be established now?

3. Is the business salable? At what price?

4. If it continues to grow, will there be enough cash to pay the high estate taxes? Is it possible that growth will reach the point where my children or the other new owners will be unable to raise enough money to pay the estate taxes bill?

5. Should I retain management control for the rest of my life? Up to a certain age? Should I transfer management control but retain ownership? For how long?

6. Would my family's interests be served best by passing control to nonfamily management on my retirement? On my death?

7. What provisions should I make for family members not active in the business? Should I assume they might become active? Should I allocate equal shares of the business to children who are active and inactive? More to those who are active? How should inactive members share in future growth? What provisions should be made for the contingency that they might want to sell their interests?

8. If I want to transfer tax responsibility for growth to those who are taking over the business, can I avoid current income tax on the transfer? If not, what will the tax bill be?

9. Is there room in this plan for changing my objectives?

Answers to these questions prepare you for the next step—identifying and listing your objectives. These should be broken down into three categories: your own objectives, the company's and the family's. Then you are ready to develop a business transfer plan and choose the most effective methods for achieving those objectives.

One thing should be realized at the outset: Planning the transfer of a closely held corporation essentially means freezing the assets of the current owner by transferring tax responsibility for the company's future growth to new owners/managers. A good transfer plan is part of an overall estate plan that puts the freezing process in place as soon as possible, while you retain as much ownership and management control of the company as you want.

The freeze is usually the most important part of the transfer plan.

A number of tools are available for accomplishing ownership and asset-freeze objectives. The principal ones are gifts, redemptions, recapitalization, Employee Stock Ownership Plans and sale of stock.

Also, there are combinations of the

It's a challenge: Transferring control of what you have built without wrecking it—or transferring too many dollars to the Internal Revenue Service.

above. Consider each tool against your own objectives.

Gifts

Sometimes an annual gift program can achieve total transfer of the ownership and control of a family corporation. But if the stock has a high value, and continued control by the owner is a factor, gifts alone are inadequate for doing the job. Gifts are customarily used in combination with other methods.

Under present law, you can give $10,000 a year to an individual without his having to pay taxes on the money. If you are married, and your spouse consents to gift-splitting as a co-donor, the two of you can give him up to $20,000 a year tax-free.

Gifts of stock in a closely held corporation represent an ideal way for the donor to transfer the tax liabilities of future growth to his successors without incurring an immediate tax charge. The owner needs to consider carefully, however, the extent to which he wants to transfer ownership of the corporation along with the stock.

Sometimes specific situations should be considered in deciding on gifts of stock.

Adult children active in the business may not yet be capable of running it successfully. Or, as is often the case, the question of which child is the most qualified to take over is a matter of fierce family disputes. There may also be problems in transferring stock to adult children who are not active in the business. As shareholders, they might not be able to make informed decisions on company policy.

Such problems can often be avoided by putting the stock into an irrevocable trust or issuing nonvoting stock to be distributed as the gifts. Another method is to restrict total gifts to a minority of outstanding stock, thereby permitting the donor to retain control until he decides the problems have been resolved.

Redemptions

A redemption occurs when a corporation acquires its own stock from one or more shareholders. A transfer of the controlling interest in a business can be achieved through such a sale. For example, if the owner/founder owns 90 percent of the stock and his son owns 10 percent, when the owner redeems (sells) all his stock in the corporation, the son is left in control thanks to his having what is now all the outstanding stock.

To the seller, the big question is whether the proceeds will be taxed as capital gains or ordinary income.

The Internal Revenue Code provides that, if the redemption meets certain conditions, the excess of the proceeds over the taxpayer's cost basis will be a capital gain and therefore taxed at the favorable capital gains rates. The most commonly met condition is complete redemption—i.e., sale of *all* the owner's stock to the corporation. A drawback is that tax rules prohibit the owner from working for the corporation for 10 years, if he is to have this tax advantage.

If the redemption does not meet any of the conditions, all proceeds will be treated as a dividend subject to ordinary income tax rates. The amount of the dividend is limited to what the code redundantly calls "earnings and profits" (usually the same as retained earnings) of the corporation at the time of investment.

Closely held corporations without sufficient cash to redeem shares of a majority shareholder, who is often the

founder of the company, can sometimes substitute property for cash. Many closely held corporations own land and other property that has appreciated substantially since it was acquired.

In a complete redemption, the redeeming shareholder can exchange his stock for the property. The stockholder has both the property and a capital gain.

Where real estate is involved, the shareholder can lease the property back to the corporation.

Recapitalization

A recapitalization is the most effective way to shift tax liability for future growth of the corporation—and to do so tax-free.

It is the most common method used by knowledgeable business owners to accomplish a formidable list of family and corporate objectives, not the least of which is continued control.

The basic recapitalization works this way:

1. The corporation issues a single class of majority voting stock—voting preferred—with a relatively low value. This stock is turned over to the founder/owner in exchange for his common stock.

2. The company also issues to him nonvoting preferred stock that represents almost all the value of the corpo-

ration's assets at the time of the recapitalization.

3. In addition, common stock with minority voting rights is issued. This stock represents the residuary value of the corporation but has little or no current value because its holders have little or no say in the company's operations. However, the stock's value will reflect the future growth of the company—if profits rise, dividend increases may not be far behind. The stock goes to family members who are to benefit from that growth.

For purposes of this plan, "preferred stock" is that with terms different than those of outstanding common stock. A new class of common stock could be "preferred."

A recapitalization is often called the ultimate tax shelter.

The founder continues to receive a salary and extra benefits, but income in excess of his needs goes back into the company, where it is taxed at lower corporate rates. He continues to control the company's growth, but the growth will not add to taxes on his estate. Some states do not permit issuance of nonvoting stock, either common or preferred.

One way to avoid such a restriction is to incorporate in another state and obtain a license to do business in your own state. An alternative is to issue two types of voting stock, one issue with a high par value, the other with a low par.

ESOPs

An owner of a closely held corporation might decide he wants to turn it over to his employees or to other nonfamily successors.

The answer could be an Employee Stock Ownership Plan. An ESOP is similar to a traditional profit-sharing plan, but it is designed for investment primarily in the employer's stock or other securities.

The first step in setting up an ESOP is establishment by the employer of an Employee Stock Ownership Trust, which does the actual investing.

It can acquire stock from the founder/owner, from the employer corporation or from both. It raises the money to buy the stock by getting a tax-deductible contribution from the employer or by borrowing from an outside source. Subsequent contributions to the trust by the employer are used to pay off borrowed funds and are deductible as made.

The trust holds the stock for the benefit of the employees and has all the rights and benefits of a shareholder. An employee's stock is distributed to him on his retirement or disability, or to his heirs on his death. In practice, the trust usually repurchases the stock from the worker or the worker's heirs.

The owner of the company shares can also take advantage of a tax provision allowing deferral of recognition of gain on securities sold to an Employee Stock Ownership Trust and another allowing an ESOP to assume liability for estate taxes connected with stock the estate transfers to an ESOP.

Sale of Stock

Outright sale of stock as a means of transferring ownership or control of a closely held corporation is generally not a good idea and should be used only in the rare event that the methods discussed above will not work. Tax consequences make a stock sale prohibitive for both the selling family member, who must pay capital gains taxes on the profit, and the buying family member, who must use after-tax dollars to make

purchase payments, which are not deductible.

At the same time, this approach is overused because of its simplicity.

Problems that must be considered include conflicting family objectives. The seller might set a high price. This would increase the taxable value of his estate and, in turn, the financial burden on the business and his family.

If the price is set too low, it could jeopardize arrangements the seller has made for his widow to receive an income, and it could be unfair to children not involved in the business.

Children in the latter category often consider stock value a principal measure of fairness in the distribution of a parent's estate.

A Final Word

Although the advice given here touches on key points, it does not begin to cover all the financial ramifications of transferring a business.

As in any complex business proceeding, competent professional guidance is needed to point out the many rules and exceptions to the rules—and the many potential traps for the unwary—in what is often the most important transaction of a lifetime.

You, your company and your family will all benefit from a properly drawn transfer plan. On the other hand, the biggest beneficiary of an inadequate or nonexistent transfer plan will be the Internal Revenue Service. ■

To order reprints of this article, see page 85.

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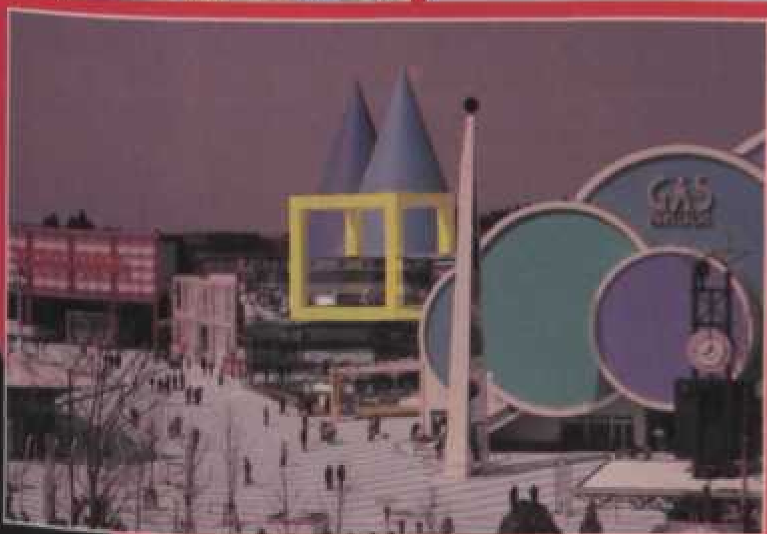

SPECIAL ADVERTISING SECTION

JAPAN

Responding To The Trade Challenge

Prime Minister Yasuhiro Nakasone is leading Japan's government toward its greatest import liberalization goals in trade history. Results of his campaign are beginning to show.

PHOTO: DAVID BURNETT—CONTACT PRESS IMAGES

"Make Friends With Imports," proclaimed banners carried in a parade through Tokyo's Shibuya-Harajuku shopping district last autumn. It was a curious sight in the capital city of the world's most vigorous exporter. It was symbolic of Japan's burgeoning campaign to defuse trade friction. Everywhere you look—in subways, on television, in newspapers, hanging from buildings and flashing from movie signboards—is the message: "Imports Bring Us Together."

Faced with threats of protectionism from the United States, Japan is responding. It is reorienting its economy and trade regulations to lessen the impact of its $50 billion trade surplus with the United States. That surplus has generated a frenzy of "Japan-bashing" in Congress, where lawmakers are threatening to impose a heavy surcharge on Japanese goods.

In interviews with NATION'S BUSINESS, more than two dozen influential Japanese businessmen and government officials said flatly that Japan must absorb more American products and make larger investments in the United States—or lose ground in its single most important market. They cite facts and figures to back up their assertions that trade friction with the United States must end.

Other articles in this year's special economic section on Japan—written by some of the most prominent names in Japanese business—provide even more evidence that Japan is working hard to realign its trade imbalance with the United States. Toshio Takai, president of the Electronics Industries Association of Japan, notes that the private sectors of both nations are working side by side to eradicate government regulations that interfere with the free flow of enterprise. Toshio Nakamura, managing director of the Japan Automotive Manufacturers Association, illustrates the strong interdependence between automakers in the United States and in Japan. Masatake Seki, general manager of the Yamaichi Securities Company, Ltd., international planning department, raises the curtain on Tokyo's bustling stock market.

Cover photo credits, clockwise from top: Ethan Hoffman—Archive, Itsukushima Shrine; Peter Paz, Japanese consumers; Hoffman, Japan Expo; Adams Liaison, Nissan auto plant.

Japan is truly emerging as an international economic power with a new sense of the responsibilities that strength entails.

In a major trade address late last year, Prime Minister Yasuhiro Nakasone bluntly told members of the Japanese parliament: "The choice before us is that of preserving and strengthening the free trading system, which is the basis of our prosperity, or yielding to protectionism and going down the dark road to global economic recession and chaos."

Nakasone—a veritable Pied Piper of bilateral economic reform—is leading Japan more from a work and savings-oriented society to a consuming society and is trying to sweep away hundreds of government impediments to foreign imports.

Japanese free traders must continue to struggle with protectionist elements in their own country. But the conviction is gaining strength that there is a limit to Japan's export growth. "Japan needs a strong America," says Naohiro Amaya, president of the Japan Economic Foundation. "A weak America is the origin of a hundred evils. And protectionism is as dangerous to the Free World as Russia's SS20 missiles. It can destroy from within."

Many Japanese government leaders recognize that bloated trade surpluses generate global economic instability. They say privately, however, that they are growing frustrated with some members of Congress who fail to give them credit for trying to stimulate imports and foreign investment. "We are not operating under socialism here," one ranking official says.

Indeed, there is a limit to what Japan's democratic government can do to influence the free enterprise of Japanese businesses and consumers. "Our target," says Ministry of International Trade and Industry policymaker Mitsugu Ishizuka, "is to make Japan the most open market in the world." Private economists argue that Japanese firms are fully ready to compete at home and overseas with all comers and must operate in a barrier-free climate in order to keep vitally needed natural resources flowing into the islands.

"I hope American business will push out its antennae into our market," says Ishizuka. But many Japanese businessmen—who labored for decades to crack Western markets—say American firms aren't working hard enough in Japan.

Yoshio Okawara is one of America's best friends in Japan. He is a former Japanese ambassador to the United States and now a special adviser to Keidanren, Japan's largest business association. He acknowledges that "five years ago Japan's market was pretty closed," but he says that is now an "outmoded perception." He advises Americans interested in exporting to Japan to make a long-term commitment, develop more patience in dealing with rules and customs and find effective distribution channels. If so, he says, they will reap some of the rewards other American firms enjoy.

Amaya says, in fact, that American companies in Japan tend to reap larger profits than their Japanese counterparts, an average last year of 6 percent over 3 percent.

Despite the harsh "Japan-bashing" rhetoric coming from Capitol Hill, there are economic forces at work that should improve trade relations between the two Pacific allies. The strong dollar—responsible for most of the American trade deficit—is dropping. Japan is moving to remove barriers to American products and services. It is also working with the United States toward bringing other nations of the Free World to the bargaining table for a new

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Japan's doors

A message from Yohei Mimura,
President of the Japan Foreign Trade Council, Inc.:
I welcome this opportunity to address the American business community on behalf of the JFTC, a private, non-profit organization of Japan's trade and trade-related industries.

As I am sure you are aware, Prime Minister Nakasone recently announced a program of bold measures aimed at providing easier access for foreign products and services to the Japanese market.

It is my belief that the government's actions are a sincere reflection of the entire nation's desire to remove any obstacles to free and fair competition. Our goal is to make Japan among the most open markets in the world.

The JFTC is well aware of the difficulties lying in the path of that goal. We choose not only to support the government's market opening efforts, but also to take immediate, independent action to help balance Japan's trade vis-à-vis the rest of the world.

are open.

We believe the U.S. and other countries can sell more to Japan.

Introducing foreign products to Japan
As key members of the JFTC, seventeen Japanese general trading companies, known as *sogo shosha*, have been constantly and actively seeking out new and innovative products for analysis, development and subsequent introduction to Japan.

The search has now been widened to include even the highly advanced and competitive aerospace and communications fields, through close cooperation with some of the best names in American industry.

Sogo Shosha, leaders of free trade
Promoting trade is what sogo shosha do best. For over a hundred years, they have been working world-wide to surmount the language difficulties, cultural differences and geographical distance that hamper the free exchange of goods between nations.

Sogo shosha are now assisting in 8 to 9 percent of America's total exports and about 70 percent of its exports to Japan. As a result, the portion of Japan-U.S. trade handled by sogo shosha has regularly shown large annual surpluses in favor of the U.S.

I am convinced that, working together, American business and the sogo shosha can take a big and lasting bite out of the Japan-U.S. trade imbalance.

If you know of a product or service that seems suitable for the Japanese market, you can contact sogo shosha at 1,300 offices throughout the U.S. and the world, or write to the JFTC directly at the address below.

You can't tell if a door is closed until you knock.

YOKOHAMA

Members of the Japan Foreign Trade Council, Inc. are participating in trade fairs held throughout Japan. The most recent fair was held in Japan's largest port city, Yokohama, where a variety of products from over 60 countries were introduced. More than 320,000 people attended the 5-day event and made numerous useful contacts for the future.

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round of talks aimed at liberalized trade. Together, the two nations have the will and the ability to pull the Free World's economic order back from the abyss of a trade war.

Strong Action On Trade

While the debate over the United States trade deficit with Japan rages in Congress and the Japanese Diet, dozens of Japanese companies are already implementing "action programs" that are boosting American exports and increasing jobs in the United States. Japanese business people are keenly interested in keeping America's economy healthy and avoiding trade friction with their biggest customer.

About one third of all merchandise exports from Japan go to the United States. That is three times more than Japanese sales to the entire European Economic Community. Also, Japan's economy is almost completely dependent on the rest of the world for its raw materials, foodstuffs and fuel, much of which it receives from the United States. American firms get one out of every five dollars Japan spends on overseas goods, almost three times more than Europe's share of the Japanese import market.

Many of the same large Japanese companies that make money selling to Americans also make money—through their import trading subsidiaries—selling American goods to Japanese. And they make money producing merchandise in the United States with the help of American workers and American suppliers. Consequently, they are highly sensitive to even slight changes in the American marketplace. A recession in the United States usually throws Japan's economy into a tailspin. Likewise, since the Free World's two leading economies are so interlinked, recession in Japan is quickly felt in the United States and among its other trading partners.

Japanese firms strive, collectively, to maintain some trade surplus because any

Sony Corporation is one of dozens of Japanese firms that have boosted imports and stimulated investments overseas. In this Sony Plaza shop, American products are in demand.

PHOTO KIM NEWTON

economy as dependent upon trade as Japan's is vulnerable to events far from its shores. As recently as 1980, beset by spiraling imported oil prices, Japan's current account balance with the world was almost $14 billion in the red.

Dependence on imported energy is greater for Japan than for any of the other major industrialized nations. The American economy was badly rocked in recent years by oil import shortages, even though only 12 percent of its energy comes from abroad. Japan imports 82 percent of its energy. Almost 100 percent of its iron ore comes from overseas and 97 percent of its copper, 87.5 percent of its lead, all of its aluminum and nickel, and 65 percent of its wood.

Japanese business people—on the cutting edge of the economy—know trade friction is intolerable. That is why they are months into a private-initiative program to alleviate tensions with important trading partners. It has already yielded for American companies many billions in increased exports and many billions in salaries for American workers. Plans are in the works for even greater expansion of American imports.

Says Ricoh Corporation President Hisashi Kubo in New Jersey: "As a corporate citizen of both the United States of America and of Japan, we at Ricoh are keenly aware of the sensitive trade issue raging between our two countries and other nations. Unfortunately, there are no 'quick fix' solutions to this situation, but we hope that the trade gap will soon come to an end through patient, balanced effort of our respective governments."

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Strong Action On Trade

Nissan's automotive plant in Smyrna, Tenn., is evidence of Japan's commitment to invest in the United States. Providing jobs for American workers and business for supply firms helps ease trade frictions.

PHOTO: THOMAS ZANA—GAMMA LIAISON

er firms, is not standing still, waiting for politicians to impose a solution.

"We have invested in the American market in the millions. We have employed American people in the thousands," says Kubo. "We have increased domestic American production of various products and components. We have joined in partnership with various American companies to export American-made products to Japan."

Calling their efforts "action programs" after free trade-promoting Prime Minister Yasuhiro Nakasone's reform package, dozens of Japan's other leading corporations are responding to the challenge.

Hitachi, Ltd., last year boosted from $120 million to $260 million what it bought from the United States for use in its manufacturing processes. It dispatched a team of purchasing agents across the Pacific to research how Hitachi could absorb the output of more American suppliers. The teams identified many more production goods, research and development equipment, semiconductors and communications facilities that Hitachi can purchase.

It increased its investment in existing American-based plants and announced plans to build more facilities in the States. Significantly, these new plants will produce not only for the American market but for Hitachi's worldwide markets, thus expanding the firm's potential payroll much more. Hitachi also endowed the Hitachi Foundation in Washington with $20 million for educational and cultural pursuits that will enhance Americans' appreciation of Japan.

Also, the company is strongly supporting the Nakasone reforms within the Japanese parliament. Executive Managing Director Toshi Kitamura says he hopes government actions "will enable American companies to enjoy the same access to Japan which Japanese companies enjoy in the United States."

The Toshiba Corporation demonstrated its commitment to expanding American imports quite dramatically by enunciating last year the principle that when purchasing conditions and product quality are the same between Japanese and American goods, Toshiba purchasing departments will buy the imported goods. The company announced it will double its worldwide imports of parts and materials within three years. That includes doubling its $333 billion of purchases from the States by 1988. Toshiba purchasing agents have fanned out across the United States hunting for new suppliers. They intend to open more permanent offices in America. Toshiba is also organizing world import fairs for its purchasing agents in Japan, to better familiarize them with the wares of foreign suppliers. Altogether, Toshiba is sending American vendors a clear and friendly message.

So is the NEC Corporation, which set up a new corporate division dedicated to expanding procurement of foreign materials and goods, particularly software and semiconductors. Also, NEC, long an important supplier of telecommunications equipment to Japan's NTT phone system, supports the recent deregulation of the telecommunications market in Japan. "We see a real opening," says Executive Vice President Shozo Shimizu. "The Japanese telecom market has become the freest in the world."

Shimizu encourages American firms to come to Japan and join the electronics associations, and he offers the marketing advice that exporters to Japan should concentrate some of their efforts on the private telephone market and on local government communication needs, together amounting to 60 percent of the national market.

"We welcome American competition," Shimizu says candidly, "because we would like to do more business in the United States. Bilateral trade is good for us both." NEC is also expanding its investments in the United States by adding two new plants, bringing the total number to nine.

Masaharu Matsushita, chairman of Matsushita Electric Industrial Company, Ltd., advises would-be American exporters to the Japanese market to learn from the persistence of the Japanese both in marketing and in dealing with a host country's regulations. In making early sales of Panasonic, Technics and Quasar products in the United States, Matsushita says his company encountered many obstacles in attempts to provide American consumers with the high quality products they demanded at affordable prices.

He also notes that Matsushita is now searching for consumer goods it can bring into the Japanese market. Last year, the company brought in more than $500 million worth of imports, including electrical products, metals, lumber and liquor. Still, says Matsushita, "it is difficult to find foreign products that Japanese consumers want." He urges American firms to take the time to conduct thorough market research to see how their products can best be adapted to Japanese culture and sociology.

Sony Corporation's philosophy is: "As a country depending on free trade, Japan has an international obligation to offer high quality products, advanced technology and services to other countries and at the same time to import actively from her partners." Sony's plans call for increasing its imports by 42 percent over last year.

Its action program goals include acquiring more picture tubes from American factories. It will also increase from 17 to 20 its Sony Plaza shops, bustling retail centers offering American and other consumer goods. It will cosponsor "import fairs" at major Japanese department stores. It is increasing its overseas procurement force and using more American shippers to move its goods. Sony is also offering low-cost loans to its workers wishing to buy certain foreign goods and encouraging workers to travel more overseas.

Yutaka Kume, president of Nissan Mo-

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tor Company, Ltd., encourages the government to press forward with its trade–expanding reforms. "I look forward to these measures dissipating the heat of anti–Japan sentiment recently mounting in the United States and contributing to the preservation of the worldwide free trade system as well as revitalizing the world economy," he says.

But Kume cautions that there are limitations to the government's ability to perform miracles in Japan's free economy. Nakasone's action program, says Kume, cannot work "without due regard for market principles and consumer preference. I am convinced that disregarding these factors may result in failure to achieve the desired effect of alleviating the trade imbalance."

The Nissan president's viewpoint is shared by other senior Japanese executives who advise their American counterparts to work as hard in learning Japanese tastes as Japanese firms did to penetrate the American consumer market.

Toyota Motor Corporation boosted imports of parts, materials and equipment 28 percent last year as the foundation of its own action program. It is also using more American ships to move products and purchasing more computers to aid in production. And in yet other ways Toyota is striving to reduce the trade deficit, for example buying more American medical equipment to upgrade its company hospital. In its extensive sales promotion campaigns, it is using more foreign goods, in hopes of whetting consumers' appetites more for Western products. Its foreign sourcing plans bode well for American manufacturers of carpeting, textiles, headlights, leather upholstery and glass.

In fact, however, Toyota has for years been increasing the level of foreign goods as components of its vehicles. Between 1980 and 1984 the value of imported parts and materials tripled.

Sanyo Electric Company, Ltd., imports from the United States doubled in 1985 from their 1984 level. Says Sanyo Director Takao Tominaga, "Our work is worldwide, so we try to help solve trade problems in order to pursue our activities." Sanyo historically has drawn in a wide array of consumer products from abroad for sale in Japan. Sanyo researchers are hunting now for more products they can import for sale to Japanese consumers. But, observes Tominaga, "importing is not the sole solution." Increasingly, he maintains, multinational Japanese companies like Sanyo must produce more in the markets whose consumers they serve. "We will increase local production on a worldwide basis," says Tominaga.

Mitsubishi Electric Corporation is moving also along a two–track plan to diminish strife with its best customer. It is expanding its production activities in the United States by opening a new plant near Atlanta, where it will manufacture mobile phones, television sets, personal computers and other high tech goods. It is also entering into joint ventures with General Electric and Westinghouse Electric Corporation.

On the second track, Mitsubishi is expanding by 24 percent the products it imports into Japan for use in its industrial processes. Its goal is to increase its imports from 1984 to 1987 almost threefold.

There were many factors involved in Mazda Motor Corporation's decision to locate its new auto plant in Michigan, but the benefit is clear for the economy of a state strongly affected by car imports. Many former auto workers will have an opportunity to return to the assembly line.

"The Big Three [American auto manufacturers] laid off many workers," says Ichiro Maeda, managing director of Mazda's Tokyo office. "Employing these people is one good way to alleviate trade frictions." Maeda sums it up for most Japanese business executives NATION'S BUSINESS interviewed late last year: "For international economics to continue to develop, we must have free trade. If Japan keeps exporting and bringing money in, it will not work well for the rest of the world."

Japanese business is responding to the American trade predicament. It is saying in bold dollars and yen that trade between the two nations is indeed a two–way street.

Automotive Interdependence

By Toshio Nakamura

As U.S. Ambassador to Japan Mike Mansfield has pointed out, U.S.–Japanese ties are among the most important bilateral relations in the free world. Trade between the two Pacific Rim countries in 1984 amounted to $86.8 billion on a Japanese customs clearance basis, which translates to approximately 22 percent of world trade.

The interdependence that results from this trading relationship is clearly exhibited by the Japanese and U.S. automotive industries. In today's world the two industries are both partners and competitors. Their interdependent relationship extends back and forth across national borders and includes U.S. and Japanese suppliers as well as the vehicle manufacturers in each country. Below are some illustrations of this cooperative phenomenon.

General Motors Corporation holds a 38.6 percent interest in Isuzu Motors, Ltd., and a 5.2 percent interest in Suzuki Motor Company. Both Japanese car makers supply subcompact models to GM that are sold by GM dealers under the company's name. Further, GM and Toyota Motor Corporation hold equal interests in New United Motor Manufacturing, Inc., a joint venture in Fremont, Calif., which produces the Chevrolet Nova.

Ford Motor Company has a 25 percent equity stake in Mazda Motor Corporation and, through this tie–up, Mazda sells small Ford cars in Japan. Mazda will also establish a U.S. car manufacturing operation in Flat Rock, Mich., and of the 240,000 cars it expects to produce there, 170,000 will be sold as Fords.

Chrysler Corporation has agreed to increase its equity holding of Mitsubishi Motors from the current 15 percent to 24 percent by mid–1986. Mitsubishi currently supplies Chrysler with subcompact cars and engines for passenger cars and light trucks. The two automobile makers have also announced the establishment of Diamond–Star Motors Corporation, a joint venture that will produce small cars at a new manufacturing plant in Bloomington, Ill. The planned yearly production is 180,000 units, half of which will be sold as Chryslers.

Direct investment by Japanese automobile manufacturers in overseas markets is another important indication of ongoing interdependence. For example, in 1978, Honda Motor Company invested $258 million to build a manufacturing plant in Marysville, Ohio. Annual capacity at the plant was 150,000 units. An additional $240 million has been invested, and output capacity will be increased to 300,000 units in 1986.

Nissan Motor Company invested $660 million in a manufacturing plant in Smyrna, Tenn., and since 1983 has produced 180,000 light trucks a year. In 1985, Nissan increased its cumulative investment to $745 million and now produces an additional 120,000 subcompact cars annually.

Toyota Motor Corporation has also announced plans to build a new manufacturing plant in the United States. Planned annual capacity of the plant is 200,000 cars beginning in 1988.

The positive social and economic impact these investments have upon the local and national community in which they are located is particularly significant. The investment creates jobs, serves as a cata-

RESEARCH

The fruits of Hitachi's ongoing research (from left to right): computed tomography, lasers, robots, a computer-scanned human eye, and optical memory disks.

For seven and a half decades, Hitachi has conducted research with single-minded devotion. As one of the world's foremost operators of independent research facilities, Hitachi's original technologies have made the company an innovator of electrical and electronics products. Most recently Hitachi opened its 21st R&D center, the Advanced Research Laboratory. Its purpose: To develop long-range projects for applications in the 21st century and to carry on the Hitachi tradition of pioneering research in biotechnology, material science, software science, and other technologies upon which progress depends.

The results are in use all around you

Hitachi laser research has allowed high-density recording of business data in optical disk filing systems. Complex manufacturing operations have been automated thanks to advances in robotics, creating intelligent machines with sophisticated sensors to help them see and handle work pieces. New audio/video systems make use of Hitachi's digital technology for ultrahigh-fidelity sound and high-definition television pictures.

Each year, Hitachi devotes some $1 billion to research. Our efforts to further improve advanced technology involve the talents of 16,000 R&D personnel. And our desire to share the benefits of new knowledge with others has made available over 35,000 patents for licensing worldwide.

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Our vision of the future includes satellite networks employing laser telecommunications and remote sensing systems to link every corner of the globe and eventually the planets. We see tomorrow's society served by energy-generating fusion reactors, 300-mph trains floating above the ground on superconductive magnetic fields, 3-D color scanners for medical diagnosis and simulation of operations—and much, much more.

We'd like you to share in the benefits of our scientific research, covering the next generation of microchips, new ceramics, information processing systems, and other high-tech innovations. For improved business efficiency. For a higher quality of life. Two goals we've pursued for 75 years as part of our commitment to a better world through electronics.

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lyst for the transfer of technological and managerial information and firmly establishes good corporate citizens within the community.

In addition to the establishment of overseas automobile manufacturing plants, 14 Japanese automotive parts suppliers have invested in the United States. This number is expected to rise, in conjunction with increased U.S. production of Japanese motor vehicles.

Furthermore, the U.S. auto manufacturers procure switch assemblies, car audio equipment, clutch assemblies, measurement devices and a variety of other parts and components from Japanese automotive parts suppliers. In fact, in 1983, GM established a parts suppliers organization called GM–Kai (GM Contractors Conference) to help facilitate communication between the auto company and its suppliers.

The complex interdependent relationship involving the two automobile industries was succinctly described in the Massachusetts Institute of Technology report, "The Future of the Automobile." The report pointed out that because auto companies have competitive strengths, they also have competitive weaknesses. "Therefore, there will be many new opportunities for competitors to bargain strengths and weaknesses."

The ongoing globalization of the automobile industry to meet the challenge of diversifying consumer demand is gathering momentum. The deepening and widening interdependence among the national automobile industries constitutes part of this globalization. Further, the dynamism of this "go global" movement will be supported best in the world's most mature and competitive market, the U.S. automobile market.

Toshio Nakamura is managing director of the Japan Automobile Manufacturers Association.

An International Financial Center

By Masatake Seki

With its 1985 gross national product estimated at almost $1.473 billion, the Japanese economy ranks second only to the United States' in the nonsocialist world. Despite its great potential, the Tokyo financial market is still far behind those of New York and London in international activities.

But recently, Tokyo has been rapidly catching up with the other two financial centers and is becoming an important place for large corporations.

The conditions necessary for an international financial center to materialize are: political stability, stable economic growth, well-organized domestic capital and money markets, liberalization of foreign exchange controls, and developed infrastructure and expertise relating to international finance. In Japan, the first three conditions have been established for some years, but the nation has lagged behind in the last two.

Rapid advances have been made toward liberalization as a result of the revision of the Foreign Exchange and Foreign Trade Control Law in 1980, and the accord reached by the Japan–U.S. Committee on the Yen–Dollar Exchange Rate. Moreover, Japan has been actively setting up the facilities and acquiring the specialized knowledge for engaging in the international finance business.

As a result of the liberalization of Japan's financial system, activities in the Japanese capital market are increasingly taking on an international character. Investment by nonresidents in Japanese securities is gaining in both width and depth. In the first nine months of 1985, the daily volume of stocks and bonds traded in Japan by nonresident investors reached $947 million. Japanese investment in foreign securities, mainly U.S. Treasury bonds, is gaining great momentum.

In the first nine months of 1985, net outflow of capital through investment in overseas securities hit a record $37 billion. The daily turnover of foreign bonds by Japanese investors in the same period reached $1.3 billion. With an estimated current account surplus of $48 billion for 1985 and a deficit of the long–term capital account estimated at $66 billion, there is a good possibility that Japan's net foreign assets will top $100 billion shortly, making Japan the largest net creditor nation.

In the field of raising capital, progress has been made as a result of relaxed government regulations. Since Dec. 1, 1984, foreign and Japanese private corporations have been allowed to issue Euro–yen bonds. By the end of last September, 17 companies, including 15 American corporations, issued straight bonds worth 263 billion yen in this market. In the Euro–yen market, 10 dual currency bonds and three zero coupon bonds were launched in the same period.

The new relaxed rules have enabled many foreign corporations to list their stocks on the Tokyo Stock Exchange with simultaneous placement of stocks among at least 1,000 investors.

Another new move is the issuance and placement of foreign currency bonds in Japan, so–called shogun bonds. Seven issuers including the World Bank, Sallie Mae and Southern California Edison Company have raised funds in this way.

Daily turnover of stocks traded on the Tokyo Stock Exchange in the first nine months of 1985 reached $1.3 billion, a figure exceeded only by that on New York's Big Board. The TSE recently decided to increase seats of regular members from 83 to 93. Several foreign commercial banks are applying for membership. Currently, 76 foreign commercial banks operate in Japan under a banking license.

There are currently 14 licensed foreign investment banks doing securities business in Japan. Although cooperation between commercial banks and securities will make further progress, the fundamental spirit of separating financial business into commercial banking and investment banking will be respected and remain unchanged for the benefit of all parties concerned.

Masatake Seki is general manager, International Planning and Development Department, Yamaichi Securities Company, Ltd.

U.S.-Based Electronics

By Toshio Takai

Japanese electronics companies see the United States as the leading force in their field. Firms in Japan built their foundations upon American technology in the 1950s.

There were almost no defense industries operating in Japan after World War II. Consequently, modern Japanese electronics developed primarily in the civilian economic sector. Japanese firms became known for their radios, televisions, tape recorders and, recently, VCRs.

Using their own original methods, Japanese electronics companies adapted and moved beyond what they had learned from the Americans in the 1950s.

Take the transistor, for example. It was developed in 1948 in the United States and used initially by the military. But when it was introduced in Japan, it was quickly brought into use for nondefense purposes. It was successfully microminiaturized, made lightweight and more energy–efficient, reduced in price and given a longer life span.

The fruits of Japan's electronics manufacturers have become well accepted throughout the world. The industry exports

SPECIAL ADVERTISING SECTION

more than 10 million television sets and other products annually. Japanese electronics firms have devoted themselves to creating "original products" distinct from goods produced in the West. Tape recorders and VCRs are representative of Japanese innovations that are not produced by American companies.

Japanese manufacturers' concept of "original products" means the merchandise must be easy to use, come in an assortment of rich designs, be priced low as a result of mass production techniques, be of the highest quality, be well serviced and meet the specific tastes of consumers. It has been a winning formula for these companies everywhere in the world.

Technological development proceeded apace also in computers and communications equipment. Japanese technology in these fields nearly reaches the level of accomplishment in the United States and European countries. The concept of "original products" is also observed consistently in this field and, therefore, is winning for Japan a good reputation in the world market.

Still, it is noteworthy that the Japanese electronics industry has grown up mostly in the United States, the world's largest market. Products are both exported and supplied from American-based production. The amount of accumulated direct Japanese investment in the United States is many billions of dollars. The number of Americans earning a living working for Japanese electronics firms in America has grown from 20,000 in 1983 to an estimated 30,000 at present. Investments and employment are expected to continue to grow. The Japanese hope such investments will help reduce unemployment in the United States. Needless to say, they also help reduce the bilateral trade imbalance.

Japanese business activities in the United States have been mostly successful, but it should be noted that this success was not brought about by aggressive business development. It is the result of long years of marketing, product reliability, developing business by reinvestment, feedback from American customers and local society and the transfer of management to Americans.

The president of one major Japanese enterprise says there are basic principles that are essential in the development of overseas business:

- Develop products keyed to the requirements or desires of consumers in a specific market.
- Follow the customs of foreign countries or, if necessary, turn over management to local people.
- Perform exhaustive technological transfer, using the most modern methods.
- Obtain an after-tax profit large enough for reinvestment.

This method works best in a free trade environment. In industrially advanced nations, free trade should be maintained and further developed under balanced conditions. Technology knows no borders. Borders should be removed for business enterprise as well. Japanese enterprises are participating in and cooperating with electronics-related associations in America and Europe—just as some 20 foreign companies have joined the 600 member companies of the Electronics Industry Association of Japan.

Japan is an open market for everyone who enters it. The government's standards and approval processes for products is as much a hindrance to Japanese business as it is to foreigners. Attempts to mitigate these government restrictions are under way in the Japanese government. They should be removed in the near future. The problem of government regulations has already been studied by EIAJ in cooperation with the American Electronics Association, with which EIAJ has a friendly relationship. Both groups are working toward more balanced trade between Japan and the United States. They are exchanging lists of products they wish to sell in each others' countries.

The Japanese government announced its action program for the improvement of Japan-U.S. trade relations in July, 1985. Keeping pace with it, major Japanese enterprises have announced their own action programs. The companies in the electronics industry have developed a plan to buy at least $700 million more of American products.

Already, many practical actions are being taken to enlarge American imports into Japan. Import-promotion missions are going to the United States, led by top management officials. The Japanese are even advertising in American newspapers for items they wish to purchase. They are organizing exhibitions of import goods.

Nonetheless, such efforts inevitably have a limit. In order to realize more balanced trade, Japan should aim at improving the situation both governmentally as well as through the efforts of Japanese companies and consumers. This goal should be based on the understanding that Japan and the United States must coexist.

Both the Japanese and the United States' electronics industries will grow continuously. In 1984, the American electronics industry output was $172.5 billion. The Japanese figure was $70.8 billion, 40 percent of the American achievement. This ratio is expected to remain stable in the future. Japanese firms plan to produce more goods abroad.

A final note. This is precisely why a system of "worldwide unitary tax" implemented by certain state governments in America is hampering free enterprise. It forces foreign companies to pay double income taxes. The Japanese hope an improvement can be made in the situation.

Toshio Takai is president of the Electronics Industries Association of Japan.

Tofu Diplomacy

The Kikkoman Corporation has its own unique prescription for alleviating any sort of international friction between people: Give them a good taste of each others' food. With exports of its soy sauce and other condiments and spices to the rest of the world and its imports of Western food into the Japanese market, Kikkoman has helped bridge the cultural gap.

Its most recent initiative is the introduction of its brand of tofu into the American market, starting in San Francisco and Boston. Tofu is a soybean byproduct that takes the form of a gelatin-like cake. It is highly nutritious and tasty when used in many recipes. Managing Director Yuzaburo Mogi found out just how delicious it can be when the results were in from the annual cooking contest Kikkoman hosts for American high school exchange students it brings to Japan. The winner, a New York girl, served fried tofu balls with spicy seasoning. The "best taste" winner, a Virginia girl, molded tofu into the form of a refrigerated cheese cake. "We were quite amazed at the variety of uses of tofu the American students discovered," says Mogi.

He expects his new product to perform well in the American marketplace, where consumers are fast developing a taste for a variety of Japanese foods. Kikkoman will offer firm tofu cakes with a long shelf life-

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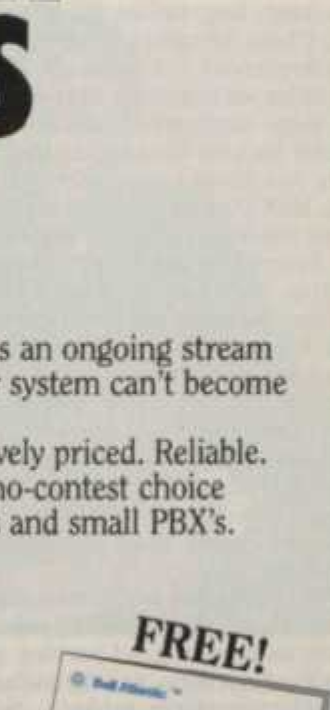

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COVER STORY

Business Outlook '86

Continued from page 30.

Entrepreneurs: Still On A Roll

In 1980, long before the infant decade had been identified as the "age of the entrepreneur," Thomas M. McMahon quit his job running a 230-person unit of a large engineering consulting firm to start his own company in Reading, Pa. He was joined by two partners, William M. McMahon (no relation) the next year and Daniel J. Castellani in 1983.

Spurred by the energy crises of the 1970s, they had a vision: They would enable business and government clients to keep costs down by helping them find ways to reduce their use of energy or convert to cheaper energy sources. Because "energy seems to be the thread that runs through everything we do," says Tom McMahon, the company was named ENTECH Engineering Associates, short for "energy technology."

ENTECH has performed energy audits for nursing homes, schools and hospitals; redesigned parking garages' lighting systems; and consulted on hydroelectric power projects. Now it is even working on a way to use waste heat from a power plant to grow lettuce in greenhouses.

The company has survived the skittish first five years that fell 90 percent of business startups. In ENTECH's initial year, revenues were $10,000. The partners expect it to bring in more than $1 million in 1986, and staff has grown to 26—more than half of them professionals.

McMahon and his partners are finding fulfillment in the age of the entrepreneur. But is the decade living up to its promise for others? It would seem so. Experts generally agree that since 1979, businesses have been forming at a rate unprecedented in history—about 600,000 a year. Part-time sole proprietorships made a "gigantic increase" of 468 percent from 1979 to 1983, according to Thomas A. Gray, Small Business Administration director of economic research. "That's a major behavioral change," he says.

Gray attributes the burst of entrepreneurship that began in the 1970s to

The energy crises spurred Tom McMahon (right) to become an entrepreneur. He and ENTECH partner Dan Castellani go over plans for a hydroelectric facility the firm is designing for Reading, Pa.

PHOTO: T. MICHAEL KEZA

the rise in oil prices that lowered Americans' standard of living. One way to adjust was to start a part-time business out of the home, and many Americans did just that.

Other forces have added to the momentum, including periods of high unemployment and, more recently, mergers and acquisitions that put upper middle managers out on the streets.

In addition, "the two-career family produces income that enables one of the spouses to take a shot at something," says Zenas Block, clinical professor of management and associate director of the Center for Entrepreneurial Studies at the New York University Graduate School of Business.

Block estimates that more than 300 universities now offer courses in entrepreneurship, another factor that he believes will lead to more business startups.

Gray says that part-time sole proprietorships are good practice for beginning entrepreneurs.

"Even if it's selling Avon or Amway products or some other small venture, it's the first step in becoming a full-blown business," he says. "It's very important to society that a lot of people use their initiative to defend their standard of living. And it's also important for the training effect that it has for business in the future, because a lot of people are beginning to *think* like entrepreneurs."

One of those part-time entrepreneurs is Deborah J.H. Livingston-White, 38, of Oak Park, Mich., who took the plunge in October. An ambitious black woman with a doctorate in education and licenses to sell real estate and life insurance, she is a special education consultant with the Michigan Department of Education. But she became frustrated by lack of upward mobility in her career. "It didn't matter how hard and long I worked, I wasn't going to get any more money," she says. "There was nothing I could do. There was no career ladder."

She started a business—with her husband, William Tyrone White, a Ph.D. in health administration who works for a large insurance company, as her after-hours vice president—and

Is this truly the age of the entrepreneur? Explosive growth in the rate of new businesses formed yearly says the independent spirit is still alive.

called it International Consultants. Livingston-White hopes it really will be international someday, with its fingers in a number of pies, including health and business consulting and developing educational materials for the learning disabled. But for now, she is launching it with an Amway distributorship and expectations of $24,000 in first-year revenues.

Though he expects the entrepreneurial spirit to remain strong the rest of the decade, SBA's Gray says we could see a somewhat lower increase in the business start-up rate. This year will be one of continuing, albeit slow, economic expansion, he says, and more people will have wage and salary jobs—jobs they will be reluctant to give up in order to go into business. In years to come, there will be fewer women and young people for the labor market to absorb, meaning a possible increase in attractive job opportunities and less impetus to go into business for oneself.

However, George L. Bernstein, chief executive officer of Laventhol & Horwath, the nation's 10th largest certified public accounting firm, asserts that the underlying conditions that produce new enterprises will continue. "I just don't see any reduction in entrepreneurial activity in terms of start-ups," he says.

Where will the money come from for new ventures? Initially, where it has always come from: savings, family and friends. "We call it the 'Aunt Nellie' bank," says Gray, noting that a major problem for black entrepreneurs is that black income is only about 60 percent of white income, and black wealth is only about one third of white wealth. Blacks are at a "distinct disadvantage" in raising capital to start a business, even from Aunt Nellie, Gray says.

Deborah Livingston-White concurs. One reason she and her husband started with Amway was that they could get into business, including stocking initial merchandise, for around $1,000.

Entrepreneurs looking for venture capital may have to keep their expectations modest. The amount of venture capital at work soared from $3 billion in 1978 to about $14 billion in 1983. In 1985 it stood at about $17 billion. "So the growth from 1983 to the end of 1985 really is not very significant," says C. Richard Kramlich, managing general

Frustrated by lack of upward mobility in her career, Deborah Livingston-White started a business with her husband, Tyrone White, in October. They hope their Amway distributorship will be the launching pad for an international consulting enterprise.

PHOTO: JUNEBUG CLARK

partner of New Enterprise Associates, a technology-oriented venture capital firm with offices in six cities.

He thinks there could be a "modest resurgence" of venture capital activity in 1986, however, moving to $3 billion for new businesses compared with $2 billion in 1985.

"Hot" areas for new businesses include telecommunications, biotechnology, computer applications, computer software, computer consulting and the services industries, according to New York University's Block.

"The communications industry is going to continue to be very explosive," says Kramlich, who also gives a vote to specialty retailing, such as the private warehouse clubs popping up throughout the country.

Tom McMahon says social and demographic changes are producing opportunities for ENTECH to help design day care facilities and life care centers. "The spectrum is just fantastic, and it gives opportunities for all sorts of people in the economy," he says.

"It's always a good time" to start a business, contends Block. Kramlich is more guarded. Now is a good time "so long as you understand it's being launched into choppy seas," he says. He advises having a tightly focused plan with adequate resources and experienced management—in other words, "a strong ship and plenty of provisions."

Block does not like to apply the word "fail" to new enterprises.

"Most businesses don't exist after the first five years," he says. "That doesn't mean they failed." Often a loss is minor, or an enterprise is just a step to another, more successful business.

"Very many successful business starters are people with previous false starts," Block notes. "Among entrepreneurs there's a saying: 'You really can't be successful until you've had at least one bankruptcy.'"

For would-be entrepreneurs, Bernstein has some advice: "Try to think through the first several years of your business—not only in terms of capital needs but also key personnel needs, key marketing needs and key milestones to accomplish. Do some thinking first. And *then* take the plunge!"

—*Sharon Nelton*

COVER STORY

Business Outlook '86

Marketing: Hotter Competition

Television ad spending is expected to reach $22.5 billion this year, fueled by strong local and cable advertising.

Network TV is expected to see a pickup after a 1985 drop.

PHOTO: JEFF ZARUBA-FOLIO

Slower market growth—and consequent tougher competition—will make advertisers more demanding this year, experts say. Though advertisers will be spending more, they will expect bigger returns on their dollars.

Overall, says Robert Coen, McCann-Erickson senior vice president and director of forecasting, ad spending is falling more in line with the economy. "Disinflation and a sluggish economy have shocked many people in the ad industry who thought the boom was going to go on forever," he says. In an interview with NATION'S BUSINESS, he provided projections for advertising year 1986.

Advertising expenditures will not grow as heartily as they did a few years ago, Coen says. Advertisers are more cautious about where they spend their money, and those selling media time and space will be seeing the effects of tighter advertising budgets. After the 15 percent increase in spending on advertising in 1984—due not only to the stronger economy, but also the Olympics and the elections—last year's 8.5 percent increase was disappointing, Coen says. He expects ad expenditures to increase less than 8 percent in 1986, bringing them to a little over $100 billion.

This year will also be one of more intensified global marketing efforts, says American Marketing Association President Manuel Plotkin. Citing "greater interest in foreign competition and greater need for marketing knowledge on a global basis," he says his association has set up a global marketing division as a way for marketers to learn how to promote their goods abroad.

Traditionally, says Coen, more has been spent on advertising in the United States than in the rest of the world. But he predicts that by the end of the decade, spending in other countries will surpass that in the United States.

Foreign businesses will also be aggressively stepping up their marketing efforts in their own countries. Advertising abroad will be "a lot more exciting and energetic in the upcoming year," Coen says.

Alvin Achenbaum, chairman of the New York marketing and management consulting firm of Kanter, Achenbaum, Associates, Inc., does not share Coen's enthusiasm about international marketing.

He says that the opportunities may be more a matter of talk than of reality, because cultural differences may mean advertising techniques cannot be universally successful.

"While there may be some commonality among countries, there are enough differences to suggest that it's highly unlikely that what will work from a marketing point of view here will work everywhere else," he says.

Predicting market saturation and merchandise proliferation in the United States, Bert Rosenbloom, a marketing professor at Drexel University, in Philadelphia, says the battle for market share will also be heating up. Instead of risking failure of a completely new product, more marketers will be promoting different versions or line extensions of well-known brand names, he says. Variations on their own themes increase marketers' opportunities to sell to more segments of the population.

"I understand Alka Seltzer is coming out with a lemon-lime version of its product because the market has become so crowded," Rosenbloom says. Fast food chains "are extending everything they can think of—like hamburgers with lettuce and tomato," adds Coen.

But because there are more national brands in foods and toiletries these days, the manufacturers' ability to make their advertising and brands distinctive has diminished. They will also be paying more to retailers for product displays and other promotions to push their products, says Achenbaum. "The national brands don't have the leverage they used to have," he says. "Retailers are in a position to extract more and more promotional allowances from the manufacturers, and therefore their power is growing."

But product proliferation has caused some casualties, says Achenbaum. "Designer labels in soft goods that were so important in department stores have begun to lose their glow," he says. "Many of the manufacturers sold their goods to off-price stores and expanded their lines of merchandise so much that they debased the value of a designer label."

Another reason for the intense battle for market share, explains Rosenbloom, is that "consumers have been conditioned to expect more," in large part

Advertisers are feeling the pinch. To get the best for their bucks they are turning to vehicles such as newspaper inserts and going after new consumer populations on other shores.

because they have been seeing more foreign products. This means that a marketer must work harder to convince consumers that a particular product is the most attractive, he says.

This also means diversification of retail competition to pull in a more demanding and sophisticated consumer. "It's particularly noticeable at the retail level," says Rosenbloom. "Department stores that used to compete against other department stores are today competing against catalog showrooms, mass merchandisers, variety stores, supermarkets and direct mail."

Segmenting of markets, or focusing marketing efforts on those with specific lifestyles, or on particular ethnic or age groups, will continue to increase in 1986 as a natural reflection of the fight for market share. "When the pie isn't enlarging," says Rosenbloom, "you have to go for pieces of that pie, and segmentation is a way of doing it."

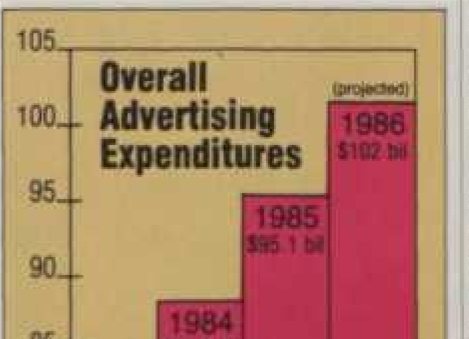
To entice more working women, for instance, Carson, Pirie, Scott, a Chicago department store, devoted a 40,000 square-foot area called "Corporate Level" to female executives interested in convenience. Corporate Level has a post office, a shoe repair shop, a computerized ticket service for shows and sporting events, seminar rooms and wardrobe planners to make a working woman's shopping excursions a little easier.

Cable television, which can also segment advertising, is expected to see another large percentage growth in ad dollars this year—up 15 percent to $775 million—though it still has a smaller base than any of the other media.

Direct mail advertising, which relies heavily on segmentation, will see the most growth in ad dollars, up 13 percent to $17 billion. And this advertising vehicle is responding to a need that was once filled to a large extent by door-to-door sales—the convenience of at-home shopping. Because of its impact, Coen says, direct mail is being used almost as widely as television advertising.

Changing lifestyles and the cost of sales calls to homes are causing some companies to restructure marketing strategies. "The average price of a sales call is approaching $100, so there is a widespread emphasis to reduce the amount of money spent on outside

Rises in U.S. advertising expenditures have tapered off in the last two years. This year is expected to see another modest increase.



Source: Robert Coen, McCann-Erickson

sales," says Rosenbloom. Avon Products, Inc., is one company that has had to change with changing lifestyles. Personal sales calls have been supplemented with direct mail catalogs because more and more women are spending less time at home to answer when Avon's calling.

Newspaper advertising—an increase of around 8 percent from last year is expected—will see the most dollars this year, an estimated $27.3 billion. Overall television advertising is predicted to reach $22.5 billion this year, fueled by strength in local and cable ads.

Network television saw a loss of approximately 2 percent in ad dollars in 1985, says Coen, explaining that "it was the medium that experienced the greatest buyer resistance and rebellion against prices." Coen estimates the average prime-time 30-second network commercial costs close to $100,000. This caused many advertisers to go to other media. But increased efforts to lure advertisers back will help boost ad revenue this year—a predicted 7 percent increase to $9 billion.

Greater availability of the "split-30" (15-second) commercial is one way networks are helping advertisers economize. The shorter allotment gives advertisers an ad message two thirds as effective as 30-second commercials at half the cost, according to M. Joseph Sirgy, associate professor of marketing at Virginia Polytechnic University.

Radio, because of its lower rates, was one form of media that benefited from network television's loss last year. Up 11 percent to $6.5 billion in 1985, all radio, including local, is expected to increase 8 percent this year. Magazines, on the other hand, will not be as fortunate, says Coen. Because of a drop-off in cigarette, liquor and utility advertising—most magazines' primary sources of ad dollars—Coen says magazines will likely see only a 6 percent increase this year.

All in all, says Plotkin, there is a lot of opportunity in marketing in the coming year and beyond. Need for more precise information on demographics and competition has been a boon to marketing research. And changes in traditionally unadvertised fields are opening up new opportunities for sending messages out to the masses: Health care, accounting, finance and law are now using professional marketing to attract new clients.

"There's a big trend in marketing of health care," says Achenbaum. A surplus of hospital beds, doctors and alternative delivery systems like urgent care and diagnostic centers has created an extremely competitive atmosphere. And since there are few marketers trained in this industry, says Plotkin, they are being recruited from other organizations. One hospital organization recruited its marketing vice president from a king of marketers, Anheuser-Busch.

—*Nancy L. Croft*

COVER STORY

Business Outlook '86

Computers: Learn From Adversity

The U.S. semiconductor industry is experiencing the longest recession in its history due to slack computer demand. Sales in 1985 were down 23 percent from 1984, and prospects appear grim for a turnaround in 1986.

PHOTO: RICK BROWN—PICTURE GROUP

The U.S. computer industry is not expected to rebound from the great slump of 1985. In all segments of the market, from personal computer software to number-crunching mainframes, 1986 will be a year of slow, unimpressive growth (see table). A shift from a seller's to a buyer's market will generate less expensive equipment and software programs designed to meet specific user needs, especially in small business applications.

At COMDEX, the world's largest computer trade show, held last November in Las Vegas, the mood mirrored the industry's changing fortunes. Downright "sober and subdued" is how Dennis Hayes, president of Hayes Microcomputer Products, Inc., Norcross, Ga., describes the show's ambience. "The bravado and euphoria are gone," he says, now that vendors realize the days of sustained 30-40 percent growth are over.

Small businesses represent the industry's biggest challenge and opportunity, says William Ablondi, of the Dallas market research firm, Future Computing, Inc. Whereas microcomputers are now standard equipment in big companies' offices, he estimates the machines have penetrated only 10 to 15 percent of the small business market. But persuading the remaining 85 to 90 percent to buy will not be easy, he says. Not only are these buyers crying out for true user friendliness, but they are also demanding practical solutions to real problems.

That is music to the ears of a few firms specializing in the design of software tailored to meet needs of particular businesses, such as restaurants and hotels. These packages, called vertical markets software, are the fastest-growing segment of the software industry. While sales of generic software like Lotus 1-2-3 will increase by about 22 percent over 1985, revenues from vertical markets products will jump 42 percent to $1.1 billion, predicts InfoCorp, the Cupertino, Calif.-based market research firm.

Vertical markets software is the right product for the times, says Robert Lefkowits, InfoCorp's software specialist. Growth should remain strong through 1990 when sales will reach $3.3 billion and account for 35 percent of the personal computer software market, he says.

The potential of this segment of the market has surprised many. Nicholas Miller, president of Sona Systems Corporation, of Redmond, Wash., a start-up planning to roll out vertical products early this year, "originally thought Sona would be lucky to do about $10 million worth of business in its first year," he says. "But judging by the activity we saw at our COMDEX booth, we now think that target will quickly be overshot."

Indeed, Sona was one of the few firms at the show to sew up sales contracts. After three days of what many exhibitors felt was unusually slow floor movement, Sona had commitments from more than 40 dealers.

Much of the interest in Sona stemmed from its demonstration of a natural language interface that enables the user to converse with the program in plain English, eliminating the need to learn any special commands or computer jargon.

Such systems are an outgrowth of artificial intelligence, the technology seen as holding the greatest promise for refurbishing the torn and tattered image of the term "user friendly." Artificial intelligence is expected to make a strong showing in software offerings over the next year.

Vendors of local area networks, bundles of software and hardware that enable personal computers to exchange data and share such equipment as printers and hard disk drives, are also expected to do better than the industry average in 1986. Only 4 percent of personal computers are linked into any kind of network, despite the fact that office workers spend two thirds of their time communicating, says John Young, president and CEO of Hewlett-Packard.

Not surprisingly then, LAN sales will more than double this year to $1 billion, says Raymond J. Noorda, president of Novell, Inc., of Orem, Utah, a leading provider of the software that drives different manufacturers' LANs.

Networks are not cheap. Connecting four personal computers typically costs up to $15,000, which can "easily exceed the price of the four stand-alone systems," says Noorda. But prices are coming down. With the industry expected to rally around IBM's recently announced token ring LAN standard, more and more vendors will be supplying products to support it. That should make LANs almost as popular as the

It will be a year of bargains and special services to entice small businesses to move into office automation.

IBM-compatible personal computer is today. By the end of the year, the $15,000 LAN will be available for $10,000, Noorda predicts.

As the shakeout continues, so will the trend toward mergers and acquisitions. For computer firms that find profits squeezed to the limit, that may be the only way to survive. The mergers and acquisitions so far are "just the tip of the iceberg," says Stephen McClellan, a Merrill Lynch & Company vice president.

With the stability of many computer firms at stake, users should be particularly careful about the company they select to do business with, experts say. "The small business person should be wary of firms with one hit product," advises Jack MacKeen, a group vice president for Digital Equipment Corporation, Maynard, Mass. He suggests asking these questions before making a purchase: Is the firm going to be able to sustain a second product? How committed is it to support and service? What standards is it going to support in the future?

There were signs at COMDEX of aggressive price cutting ahead in hardware. Tandy Corporation introduced the Model 3000, a personal computer that emulates the power and performance of IBM's AT for 40 percent less. The Tandy 3000 with a 20 megabyte hard disk drive will retail for $2,599. And Japan is bringing in high-quality, competitively priced hardware, especially such peripherals as storage systems and printers.

Also on display were laser printers that for the first time crashed through the $2,000 price barrier. At such prices, "laser printers are now printers of choice," says Richard M. Rosenbaum, a consultant with Kupferberg, Goldberg & Neimark, Chicago, who advises small businesses on computer purchases. Affordable laser printers should give a boost to desk-top publishing—a personal computer functioning as a small printing press to generate documents with high-quality graphics and different type styles.

Like vertical markets software, desktop publishing's appeal is as a complete solution. Systems that sell for between $10,000 and $12,000 will provide a $1 billion market by 1990 compared with $280 million this year, according to Creative Strategies Research International, of San Jose, Calif.

Software retail outlets are facing mounting competition from software mail order houses which typically sell packages for 30 percent less than retail.

PHOTO: ANDREW POPPER—PICTURE GROUP

Though there is virtual unanimity among industry leaders that 1986 will be a lackluster year, by no means is their long-term outlook bleak. A resurgence, they agree, should occur in late 1987, when the top U.S. maker of integrated circuits, Intel Corporation, Santa Clara, Calif., introduces its long-awaited 32-bit microprocessor. Designated the 80386, the new chip will process information at three to four times the speed of its 16-bit predecessor and "basically put the power of today's minicomputer on the desktop," asserts David Kay, president of Kaypro Corporation, a Solana Beach, Calif., manufacturer of computers.

The 80386 is the chip IBM plans to use in its next generation of personal computers (IBM owns 22 percent of Intel). Furthermore, the new chip will run all the software written for IBM's existing personal computers—something other 32-bit microprocessors cannot, says International Data Corporation analyst Michael H. Gross. That will make the next IBM PC and the clones sure to follow "immediately appealing to IBM's huge installed base of customers." Hardware sales should skyrocket, he adds.

And opportunities for software writers and publishers will abound. Putting substantially more horsepower to work will make possible programs with remarkable graphics and multiuser capabilities. Like other milestones in microelectronics, the 80386 is going to create a "revolution" in software development, says Microsoft Corporation President Jon Shirley.

—*Karen Berney*

Computer Industry Forecast, 1986

	U.S. Sales (In billions of dollars)	Percent Increase (Over 1985)
Microcomputers		
Hardware*	12.0	20.0
Software	4.9	16.6
Minicomputers		
Hardware*	14.0	16.2
Software	8.7	28.0
Mainframes		
Hardware*	18.0	12.5
Software	5.1	25.0

*Excluding peripheral devices
Sources: U.S. Department of Commerce, InfoCorp

COVER STORY

Business Outlook '86

Trade: Help From A Lower Dollar

The 1985 high-water mark in the biggest import flood in American history will be not be reached again in 1986, predicts Deputy Trade Ambassador Michael Smith.

He says the dollar's decline will continue, making U.S. goods more attractive both here and abroad. But don't expect dramatic results. "The positive signs will begin to show up toward the end of the year," Smith says.

The United States, Japan and other industrialized nations say the General Agreement on Tariffs and Trade must be reformed.

Trade will continue to be controversial in Congress as import-injured industries seek protection. America's trading partners—chiefly Japan and the European Economic Community—fear a protectionist reaction to the United States' massive trade deficit.

Eugene Milosh, president of the American Association of Exporters and Importers, says, "We expect continued growth in trade, but with a degree of danger because of trade-impeding legislation that may occur in Congress."

He predicts steel imports will stabilize, foreign textile sales will increase modestly, footwear imports will continue to take a large portion of market share, and car imports will level off. He foresees more sales abroad as the economies of America's trading partners continue to improve, and markets, especially in Japan and China, open wider.

The Commerce Department forecasts modest economic growth in Western Europe, but cautions that since its recent recovery has been so directly tied to exports, greater competition from the United States could cause its engine to sputter. Canada, America's No. 1 trading partner, is experiencing a slight slowdown in growth, dampening sales prospects there.

In Latin America, some countries have moved decisively to deal with their heavy debts, while others are still mired in crisis. The United States, however, continues to increase its share of Latin America's imports. The Latin American trade surplus with the United States is expected to lessen with the fall of the dollar and recovery in some economies in the region.

—Henry Eason

The pressure of imports will decrease this year as the dollar weakens and as demand increases for American products abroad. Still, high output factories—like this automated steel plant in Japan—will continue to make inroads on less efficient U.S. firms.

PHOTO A. HEITMANN—ARCHIVE PICTURES

Financial Services: Expanding

In 1984, James Cairns, then president of the American Bankers Association, confidently predicted that banking's financial future would be secure in 1985. Then came a series of crises: government securities dealers went bankrupt, problem foreign and farm loans hit banks hard, 100 banks failed and 459 of 3,200 federally-insured thrift institutions were found to be insolvent or have a dangerously low net worth.

The general attitude among legislators, regulators and the administration is that deregulation is to blame—it created a permissive regulatory environment where financial institutions entered unfamiliar fields with new risks and intense competition without adequate monitoring.

Although thrifts would welcome a certain amount of reregulation, banks would resist any restraints on their plans to invent brave new ways of managing money. As ABA President Donald Senterfitt says, "Bankers are making the changes and meeting the challenges that will allow them to remain the pre-eminent providers of financial services."

Banks will turn increasingly to the states to mitigate federal prohibitions on interstate banking. For example, they will form more regional interstate compacts with other banks and use state-chartered subsidiaries to enter fields such as securities brokerage, real estate and insurance.

The life insurance industry is expecting a "very healthy 1986 in terms of sales and growth," says Edward Phillips, chairman of New England Mutual Life Insurance Company. One industry worry, however, is a proposal to tax interest on life insurance policy loans as current income, making them unattractive to corporations and small busi-

What the year holds for trade, financial services, construction, retailing, freight, energy, agriculture, health care, leisure businesses and defense.

American Bankers Association President Donald Senterfitt is optimistic that banks will continue to be the "pre-eminent providers of financial services."

PHOTO: DAVID WOODDELL

Housing will lead construction activity this year and will be fueled by stable or lower interest rates.

PHOTO: SUSAN MCMAHAN

nesses, major buyers of these policies. Premium rates on ordinary and term life insurance, on the decline for the past several years, should remain stable this year. Universal life contracts, dependent as they are on short-term investments, could experience a rate hike to maintain their value if "investment rates decreased and stayed down over the next two years," Phillips says.

The biggest rate increases will be felt in the property-casualty sector, which has been left with a $40 billion underwriting loss as a result of years of rate-cutting on commercial insurance. Businesses are going to feel the crunch of "significant" escalating rates, particularly in the liability area, according to the Alliance of American Insurers, perhaps 35 percent or more. Personal coverage increases on car and homeowners insurance will be tamer—in the 10- to 15-percent range—the result of rising numbers of claims and settlement costs.

Allan Fulkerson, who runs Century Shares Trust, a Boston mutual fund specializing in insurance stocks, says he is "quite bullish" on the industry and sees a big upturn for property and casualty companies this year with continuing improvement through 1987 and 1988.

—Mary-Margaret Wantuck

Construction: A Record Year

New housing starts will lead construction into another record year in 1986.

Residential construction, says George Christie, vice president and chief economist at McGraw-Hill Information Systems in New York, will be up 7 percent from 1985, to $112.7 billion, and construction overall will be up 2 percent, to $226.1 billion.

"Stable or lower interest rates are the best thing the building industry has going for it in the near future," says Christie. They are expected to keep the housing market healthy even though rising foreclosures and massive losses sustained by mortgage insurers have caused lenders to impose tougher loan qualifications, heftier down payments and stricter appraisal requirements.

Builders are meeting the challenges of changing markets by diversifying into different types of construction.

The Real Estate Research Corporation, a Chicago consulting company, says the single most important market will be retirement housing. John Zeisel, president of Building Diagnostics, a Boston research firm specializing in evaluations of senior citizens' housing, says there will be 36 million Americans over 65 by the year 2000.

Office construction will be affected by high vacancy rates, which will remain between 16 and 19 percent for the rest of the decade, according to George Peacock, chairman of Equitable Real Estate Investment Management Company in Atlanta. Five percent is considered healthy.

Hotel construction will continue strong, especially in all-suite hotels and economy lodging, the Real Estate Research Corporation says.

Weakest construction areas are expected to be retail and industrial.

—Mary-Margaret Wantuck

COVER STORY

Business Outlook '86

To meet fierce competition, retailers are seeking ways to differentiate themselves. Experts say there will be clearer distinctions between absolute low prices on one hand and shopping as entertainment on the other.

Retail: Cautious Optimism

If the retail industry were a ship, the 1986 outlook could be described as "steady as she goes." Retailers are no more than cautiously optimistic in describing their prospects for the year.

They see slow growth, continued struggle for market share, a cooling down of buyer demand and no new, exciting products to capture consumer imagination. As a result, stores are taking a new look at themselves, defining their personalities and merchandise, and targeting their customers.

Consumers have been spending at a faster rate than income has increased, and savings levels are hitting historic lows. Eventually, spending will have to slow down—it is only a question of when, experts say.

Not next year, believes the Association of General Merchandise Chains. "Despite some highly publicized gloom and doom predictions, retail leaders tell me that 1986 sales should stay healthy," reports AGMC President Edward T. Borda. "Consumption is holding up well, though consumers are very value conscious."

Not every retailer is quite so optimistic. "I think 1986 will be, like 1985, a struggle for market share," says Andrew Lewis, chairman of Best Products Company, the Richmond-based catalog showroom discount chain. "Those that do well will be those that take customers away from others."

To meet fierce competition, retailers are seeking ways to differentiate themselves. "There will be clearer distinctions between absolute low prices on one hand and shopping as entertainment on the other," predicts Lewis.

The emergence of warehouse clubs or membership warehouses is a significant feature of the low price end of the scale. Experts estimate warehouse-type sales in 1985 at $4 billion and predict they will grow geometrically for the rest of the decade.

On the other end of the scale are stores like Bloomingdale's, Neiman-Marcus and Lord & Taylor, which emphasize service and design themes and promotions to attract customers. Even discount chains like K Mart and Bradlees are going upscale.

"Retailers will pay more attention to service as a reaction to the realities of the malls," says Michael Wellman, K

PHOTO: MICHAEL LEROY—AFTERIMAGE

Mart vice president for corporate planning. "The stores are generally very much alike, so service will be a way to differentiate between them."

—*Cecelia Blalock*

Freight: An Uneven Year

The air freight industry is soaring, but other modes of transportation are not doing so well. Trucking is largely subject to unpredictable economic fluctuations, rail is on the upswing but must keep a close eye on Capitol Hill. Barge transport is barely staying afloat.

Experts predict double-digit growth in the next five years for overnight express service, following gains of 36 percent in 1984 and 25 percent in 1985.

Regular air freight is also thriving. Paul Hyman, Air Transport Association director of cargo services, says it is expected to outperform growth of real gross national product domestically this year and do even better internationally. Much of the cargo is high tech.

Last year was not particularly good for the trucking industry. Though its share of the freight market increased slightly, tonnage was down 2 percent, and earnings dropped an estimated 15 to 20 percent. For 1986, tonnage is expected to rise no more than 5 percent, with revenues increasing between 6 and 8 percent.

"I don't see 1986 being a real winner in profits," says Ronald Roth, American Trucking Associations director of statistical analysis. "There are so many cost pressures."

And highways are steadily deteriorating. Improved roads would prolong the life of the vehicle, speed up delivery and help reduce accidents.

Railroads, on the other hand, are in their best physical condition in modern history, says Frank Wilner, an executive vice president of the Association of American Railroads. Profits have increased, enabling railroads to pour large sums into research. A prototype of a new train that is expected to drastically cut costs is due for testing by the year's end. "We are mildly optimistic about the outlook for 1986, although there are many dark clouds on the horizon," Wilner says.

The biggest challenge for railroads is getting a bigger share of higher-rated freight. Railroads now have about 18 percent of the freight market and 37 percent of the tonnage.

Though barges carry 13 percent of the nation's freight for 2 percent of its transportation costs, barge operators see no relief from hard times. Admits Jeffrey A. Smith, an American Waterways Operators Institute vice president: "It would take a business surge of unimaginable proportions to bring us out of the depression we're in."

Low demand for barges' prime cargoes, a strong dollar and reduced manufacturers' demand caused by the influx of imported goods are contributing to the industry's woes. One third of the barge fleet remains on the banks, and unemployment in the 300 shipyards that build and repair barges is 80 percent.

Still, the industry plans to hang tough. "We'll be around," promises Smith.

—*Bob Gatty*

The nation will consume more energy in 1986, with the biggest jump in oil use. But for the 16th straight year, energy use will decline as a percentage of gross national product. Coal is still the major fuel for electricity generation.

Energy: Lower Prices

Stimulated principally by lower oil and gas prices, energy consumption in the United States will rise nearly 2 percent this year, twice the increase of 1985.

Petroleum consumption will climb nearly 5 percent, predicts the U.S. Chamber of Commerce forecast section, with imports supplying a larger share than last year but less than in 1984. Natural gas use will rise 3 percent, coal use will be up 2 percent, and electric utility sales growth will be slightly less than last year's 5 percent.

This will be a turnaround year for the domestic petroleum industry, says the Chamber. After a decline of nearly 1 percent in 1985, U.S. domestic production should increase almost 3 percent, still "significantly below the 4.9 percent increase in production forecast for nondurable manufacturing as a whole."

Gasoline prices will drop 4 cents a gallon because of lower crude oil prices, predicts the Department of Energy.

The falling prices and abundant supply are bad news for oil companies, whose net income has been dropping since 1980. Refiners are hurt by cheap imports, and producers are using mergers rather than expensive exploratory drilling to increase their oil reserves.

Some voices have begun to talk of a tariff on imported oil if prices continue to fall. Since 1970 U.S. energy conservation has been the major factor in holding down the growth of consumption. The Independent Petroleum Association calculates that in 1986 U.S. energy use, as a percentage of gross national product, will be 29 percent less than it was in 1970.

The natural gas industry, after eight years of surplus supply, increased four years ago by deregulation, is aggressively seeking new customers. The American Gas Association is pushing for repeal of government restrictions on new industrial uses of gas, is working to develop more efficient gas appliances and is promoting use of gas in air conditioning.

AGA President George H. Lawrence says recent legislative and regulatory improvements affecting natural gas have contributed to "a new era characterized by abundant supply, moderating prices, new markets, new technologies and intense competition."

PHOTO: ARNOLD ZANN—BLACK STAR

The price of natural gas in some markets is now competitive with the price of coal. This has limited growth of coal use. Another restraint on coal consumption is electric utilities' increasing reliance on nuclear power.

As long-planned, expensive nuclear generators come on line, says James G. Randolph, president of Kerr-McGee Coal Corporation, "utilities want to run them full time and use coal only to meet peak requirements."

Randolph says coal exports will be helped by a weaker dollar, but more Colombian coal will be coming into the market.

The electric utility industry is in a period of change. The number of generating plants planned or under construction is the lowest in more than a decade. The decline in capital expenditures has meant less need for outside financing.

Richard Braatz, an Edison Electric Institute vice president, says companies "have begun to return to financial stability through investments in nontraditional areas" because investments in major generating plants are now considered too risky. In the second quarter last year, utilities' income from nonelectric sources was 32 percent higher than a year earlier.

Braatz adds that "long-term problems of future capacity needs must be taken up, representing a tremendous challenge for both the electric utility industry and the nation."

John Anderson, executive director of the Electricity Consumers Resource Council, says competitive pressures will result in more utilities seeking distant customers for their surplus generating capacity—"haves" selling to "have nots"—and more industrial users will try to get lower-cost power from distant sources.

—Harry Bacas

COVER STORY

Business Outlook '86

Farm auctions will continue across the rural heartland as commodity prices remain flat and export markets weaken. Federal welfare and gradually falling surpluses will by late 1986 take some of the sting out of the situation. No real help is in sight before 1987.

Agriculture: No Turnaround

It is going to get worse this year before it gets better in agribusiness, the country's largest economic sector. Bin-busting harvests, added to swollen inventories, will keep prices depressed. That will mean continued farm failures and more pressure on the rural credit system. Government will work to idle more acreage. And that will mean lost sales for chemical, seed, equipment, transportation and other firms that support agricultural productivity.

The export market promises little hope until after midyear, says Ross Korves, economist for the American Farm Bureau Federation in Chicago. As the dollar falls, Korves foresees better price competitiveness against farm exports from other countries.

"There is no indication that farm income will be any higher in 1986 than it was in 1985," the AFBF economist says, adding that as a result many debt-encumbered farmers will leave their farms. New farmers will replace them, Korves predicts: "It's a good time for young farmers to start, because land prices are good." AFBF analyses show family farms can still be competitive and will continue to play a major role in American agriculture.

The next four years, says Korves, will be much better than the last. Demand for food worldwide is growing, and American farmers' competitors—whose gains in recent years have often come at the expense of their governments' treasuries—will not be able to compete as well in the long run with superior U.S. productivity.

Assistant Agriculture Secretary Robert Thompson says that agribusiness firms "will be impacted by acreage reduction," adding that farm acreage cutbacks will be a federal goal for some time to come. The Reagan administration would like a 10 percent shrinkage over the next three years in the 300 million acres farmed in the United States. "There are too many farmers," says Thompson. Their gross output continues to keep prices too low for profitability in the group as a whole. Last year 5 percent of the country's farmers left the land. Thompson thinks about the same number will quit this year.

Stuart Hardy, U.S. Chamber of Commmerce agricultural expert, predicts that "another big bloodletting" in

PHOTO: ANDY LEVIN—BLACK STAR

rural America will result in reduced production. Prices should nose up in 1987, he says, leading to a more rational pattern of demand and supply.

—Henry Eason

Health Care Costs: Cooling The Fever

Cost control, driven by continuing market pressures and tightened government benefits, will dominate the health care industry again in 1986.

"We are in a period of review and change in America's traditional health care systems," says Sheldon S. King, executive vice president of Stanford University Medical Center.

James H. Sammons, executive vice president of the American Medical Association, sees a "continuing evolution" in medical care "from a national emphasis on maximum care to a national concentration on minimum cost."

Sammons says doctors will press legislatures and Congress to help solve the professional liability crisis that is affecting both the cost and quality of medical care. He says doctors will also increasingly switch to new forms of practice such as participation in health maintenance organizations and free-standing care centers.

An oversupply of hospital beds, caused by a decade of overbuilding and aggravated by lower admission rates and shorter patient stays, will lead to a shakeout in the hospital business in the next few years, observers say.

Investor-owned hospitals continue to gain market share from nonprofit hospitals, although some chains reported slowed earnings last year. They will have an estimated 30 percent of the market—up from 13.6 percent in 1984—by 1990, according to a study by Frost & Sullivan, New York researchers. The strongest growth is in multihospital systems and in specialty hospitals.

In addition to their own hospitals, management companies now operate 330 nonprofit hospitals under contract.

Michael D. Bromberg, executive director of the Federation of American Hospitals, says the health care revolution is forcing hospitals to reposition themselves as "health-care systems." To their standard acute care they are adding "outpatient and ambulatory surgery, home health care, long-term care like nursing homes and specialty practices like psychiatric care, women's care and sports medicine."

Private health insurance, which provides more than $100 billion in benefits annually—four times what it did a decade ago—is starting to get involved in more than just paying the bills. An increasing number of insurance companies have formed alliances with hospitals, doctors and other providers to offer "managed health care."

Metropolitan Life has a program called Met-Elect in six major cities. Participating doctors and hospitals agree to accept reduced rates and covered employees get smaller deductibles or copayments if they use them. An Aetna national network, called Partners, col-

Don Taylor has a $100,000 policy. It helps his wife, Jackie, and daughter, Monica, to have the security they need now. And he'll have the "living benefits" to help out when Monica is in college.

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Great-West Life, CNA, Crown, Western Life and MONY Financial Services have set up another network, called Private Healthcare Systems, to manage health care delivery and review patients' treatment.

"In the face of growing competition from new entrants in the health insurance market, 1986 should see our industry continue in the black," says James L. Moorefield, president of the Health Insurance Association. "At the same time, our customers can look forward to more innovative coverage aimed at helping them continue to lower the cost of their health insurance."

In addition to health care management, Moorefield says, insurers will be emphasizing programs to help keep people healthy and restore the sick and disabled to productive lives.

Frank E. Samuel, Jr., president of the Health Industry Manufacturers Association, says manufacturers will emphasize technology that helps hospitals cut costs by reducing staff needs and length of patient stay.

But, he says, "they will become increasingly wary of developing technologies that raise costs, even if they dramatically increase quality. The hard question, then, is how well major medical breakthroughs will weather cost control in 1986."

—Harry Bacas

Leisure: Sluggish Sales

"We are between Olympics," says Howard J. Bruns in explaining why sales of leisure, fitness and sports-related equipment will grow only slightly this year.

Bruns, president of the Sporting Goods Manufacturers Association, says that "while 1986 looks sluggish and a bit uninspiring, 1987 looks better" because "the 1988 Olympic hype will begin, and this industry does well during the buildup."

Retail sales will reach $28 billion. More than 40 percent of that will be in recreational transport—bicycles, boats, RVs (recreational vehicles such as campers) and snowmobiles. The rest will be in sundry other sports equipment and in athletic clothing and footwear.

In bicycles, as in other sports equipment and sports clothing, imports will account for roughly half of all sales this year.

PHOTO [illegible]

The National Sporting Goods Association says retail sales of exercise equipment, although they have grown past the $1 billion sales mark, have not matched expectations. Home gyms, rowing machines and stationary bicycles are up, but trampolines and barbells are down.

Downhill skis are growing much faster than cross-country skis. Golf and scuba gear are up. Boats are doing better than RVs and snowmobiles. And, for self-propulsion, the hottest shoes are those for aerobics.

The association says its figures seriously understate total sales, because many categories of sports clothing and equipment accessories are not counted.

Bicycle sales, which climbed from 6.7 million units in 1982 to 9 million in 1983, 10.1 million in 1984 and 10.3 million in 1985, are expected to suffer a modest downturn this year, according to the Bicycle Manufacturers Association. Imports have taken an increasing share of these sales—48.5 percent last year.

Bruns says the United States consumes 47 percent of sports-related products manufactured worldwide, and 55 percent of all sports products are made in Southeast Asia. With more than half of the U.S. market taken by imports, the industry will run a $5 billion trade deficit this year, Bruns says.

As for trends, Bruns says, "Pro sports will offer nothing sensationally new; school sports will be holding on by their fingernails; women's sports will be a bright spot, as will youth sport programs outside the school; and anything to do with a bicycle looks real good."

—Harry Bacas

Defense: Delayed Reaction

Defense and aerospace firms ironically will continue to bustle with activity and yield respectable profits in the midst of a campaign in Congress to hold down increases in military spending.

Their long-term growth is imperiled by Congress' perceived need to use cuts in proposed expenditures on arms as a weapon against the federal budget deficit. But the impact will not be felt greatly this year. Weapons systems take many years to develop and manufacture, and billions of dollars will for years to come continue flowing through procurement pipelines laid during President Reagan's dramatic first-term defense rearmament drive.

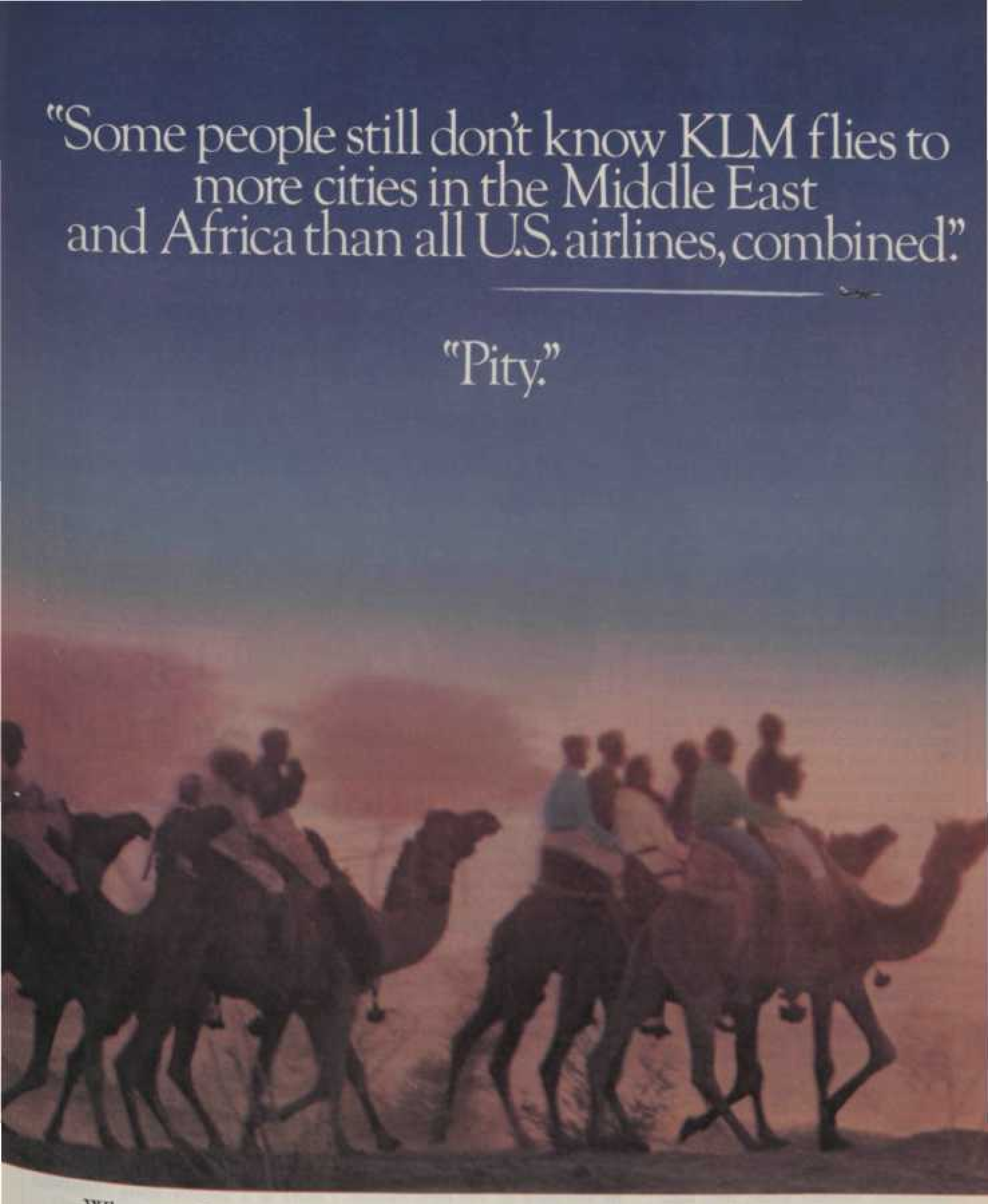
In fact some experts say the defense manufacturing sector does not yet have the capacity to fill the orders it has received from the federal government.

"There has been a continuing gap between new orders and shipments," says an Aerospace Industries Association analyst. "The monetary value of backlogs has increased. What you will see this year is a narrowing of the gap between new orders and shipments. Eventually, the value of shipments will exceed the value of new orders."

Steve Kerekes, investment director for Grumman Aerospace Corporation, says congressional proposals to eliminate federal budget deficits "will have a serious impact on defense outlays." This year "looks tight across the board," he says. Still, he concedes that Grumman—which supplies the Navy with most of its planes—will not immediately feel the pinch.

Douglas Lee, vice president of the Washington Analysis Group, an investment fund, says he expects defense firms' profits "to remain good this year." Lee says it is getting tougher for American defense firms in export markets. "In addition to the competition from our European allies," he says, "a lot of Third World countries are now making sales. Brazil is producing aircraft and tanks. South Korea is selling small arms."

—Henry Eason



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By Sharon Nelton

Winning With White Hats

ILLUSTRATIONS CAMERON GERLACH

James O'Toole wanted to prove to his students that you don't have to wear a black hat in order to succeed in business.

The University of Southern California management professor found that, beginning in the early 1970s, students were running time and again into stories of shoddy cars out of Detroit, products that damaged people's health, hostile takeovers and companies bilking the Pentagon. They were getting the idea that to make it big in business, you had to check your ethics outside the corporate door.

"I just didn't believe that was the case," O'Toole told NATION'S BUSINESS recently. "I was trying to tell my students that they could behave on the job and could run corporations with the same high moral standards with which they lead their private lives."

Five years ago, he set out to find examples of companies that "produced safe, high-quality goods; behaved morally and ethically; and invested for the future so as to preserve the jobs of their people—companies that did the sorts of things that one would like to think can happen in competitive corporate capitalism." The companies he wanted would make money "not in spite of having done those things but *because* of having done them."

His findings resulted not only in fodder for the classroom, but also in a book the rest of us can chew on—*Vanguard Management: Redesigning the Corporate Future* (Doubleday).

It was relatively easy for O'Toole to come up with small to medium-sized companies that met his standards: Peter Burwash International, Chaparral Steel Company, Felt Products Manufacturing Company (Fel-Pro), W.L. Gore & Associates, Herman Miller, Inc., Kollmorgen Corporation, Lincoln Electric Company, Lord Corporation and the Olga Company.

Many management authorities regard these companies as models of business excellence, he says. They make high-quality products and provide excellent customer service; they offer job security for employees, who are often also major stockholders; they are led by farsighted, risk-taking chief executive officers who "clearly articulate a high moral and social purpose for their firms." And, says O'Toole, "they make oodles of money."

But he continued his search because, he says, "nobody is going to buy this list." In order to prove to the giant corporations that they could do it, too, he knew he would have to identify large corporations he could point to as "vanguard" companies.

He came up with eight: Atlantic Richfield Company, Control Data Corporation, Dayton-Hudson Corporation, Deere & Company, Honeywell, Inc., Levi Strauss & Company, Motorola, Inc., and Weyerhaeuser Company.

He also came up with eight runners-up: Cummins Engine Company, Dana Corporation, Digital Equipment Corporation, Hewlett-Packard Company, Johnson & Johnson, Polaroid Corporation, TRW, Inc., and Xerox Corporation.

"Vanguard" companies are not perfect, says O'Toole. He suggests, for example, that one CEO has undergirded his corporation with "tremendous philosophy" but is careless about day-to-day administrative concerns, a carelessness that has permeated the entire organization. He calls it "the tragedy of having the right idea and failing in the execution of it."

O'Toole says the vanguard firms' excellence "derives not from perfection but from their willingness to recognize and attempt to honestly address their imperfections."

Says O'Toole: "In Japan, an executive says, 'We're in the business of making the highest quality cars so that we can bring jobs to our shores and improve the quality of life of our people.' The employee looks at that and says, 'Hey, this guy's on my side,' and there is a greater sense of loyalty there."

"I am not asking American managers to be altruistic," insists O'Toole. "I am not asking them to do anything other than make sound business decisions. I'm asking them to quit shooting themselves in the foot."

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Advertising On The Cheap

Katherine and Ron Harper found a way to get $5,000 worth of advertising for $500. A husband-and-wife-team, they own a string of businesses in Charlotte, N.C., under the umbrella of Harper Companies International. The businesses, which have combined annual revenues of $15 million, range from manufacturing printing cylinders and industrial hand cleaner to installing heating and air conditioning.

So how do the Harpers "advertise" for a song?

"We'll give an employee $500 if he or she will write and get a technical article published in a trade magazine," says Ron Harper. The trade journals go to customers that the Harper companies most want to reach. Typically, says Ron, a black-and-white ad would cost his firm $1,500 for one page (including production work for the ad); a color page would run about $2,500.

But if a magazine accepts an article that one of the 100 Harper employees has written, it usually runs two magazine pages and has much more credibility than an advertisement does.

"In my opinion, it's $5,000 worth of advertising if you measure it against the cost of advertising in the magazine," says Ron.

Harper employees have been published eight times in the last three years, he says.

Publication not only gives employees recognition in the industry, it establishes the company as having expertise, and that encourages potential customers to think of the Harper Companies as the leader in their industries.

And, because the employees usually already have the knowledge in their heads, they can turn out a piece on a Sunday afternoon.

"It's a nice, easy $500."

Getting More Outside Help

Management consultants who work with small- and medium-sized businesses may be glad to learn that some clients are finally taking their advice.

Consultants frequently urge their clients to put outside directors on their boards.

Doing so adds brainpower to a company and helps relieve a lonely chief executive of the full burden of decision making.

Now, according to Growth Resources, Inc., a Peabody, Mass., compensation consulting company, small companies are paying their directors more, and the higher pay reflects a growing trend among small businesses to bring in more qualified outsiders to serve on their boards.

GRI makes an annual survey of compensation of executives and directors in over 31,000 manufacturing, technology and service companies with sales between $250,000 and $40 million. This year's survey found that outside directors—including CEOs from related industries, professors from business and technical schools, and other professionals—now account for two of the five directors on the average small company board.

"This represents a change from the traditional small company practice of staffing boards with relatives, company officers and close advisers—such as attorneys or accountants—who are already paid by the company," says Richard J. Bronstein, GRI president.

The latest study showed a 9.3 percent rise in compensation of directors. Sixty percent of the companies that had boards compensated their directors. Most of those paid director meeting fees ranging from $100 to $650, with an average of $534—up from $479 in the year-earlier survey.

Half of the companies compensating their directors paid annual retainers of $1,000 to $6,500, with an overall average of $3,650, up from $3,260 a year earlier.

Two thirds of the companies paying retainers used the retainer in addition to the meeting fees.

The 1985-86 Growth Resources Officer Compensation Report is available for $375 from Growth Resources, Inc., One Newbury Street, Peabody, Mass. 01960, (617) 535-5500.

PEOPLE/PERSONAL

Making It

Entrepreneurial success in health care, vending machines, retirement homes and computers.

Controlling Health Care Costs

Robert J. Becker started all over again at age 60, selling his medical practice and mortgaging his belongings. Result? A national health care cost watchdog.

Dr. Robert J. Becker started his first company three years ago when he was 60.

He is not sorry. He is surrounded by people he admires, and his business not only is performing a worthwhile service, but this year is also even showing a profit.

Becker's HealthCare COMPARE Corporation, headquartered in Lombard, Ill., outside Chicago, is a national health cost containment firm that reviews hospitalization and medical treatment of insured workers. Its clients are health insurers, claims administrators and employers.

For Becker, starting a company meant giving up his private medical practice. He had to sell it and mortgage most of his belongings to raise enough money—close to $1 million. But he is sure he made the right decision.

"I knew I could do more for my own patients as a practicing physician," he says. "But I also realized I could do more societally as a medical administrator."

His decision did not surprise colleagues who knew him as a lifelong community activist.

A board-certified internist with a specialty in allergic medicine, Becker practiced for 26 years in Joliet, Ill. He had as many as three associates in his large office. He believed physicians should be available to their patients and responsible for more than just health care by appointment.

"My home phone was listed," he says. "I made house calls. I took pictures of my patients. I sent them all Christmas cards and even sent birthday cards to the kids under 16. I believed that was part of the art of medicine, of being a good doctor.

"I didn't hospitalize patients very much. I felt if I could provide people with as good treatment as outpatients as in a hospital, they would probably get better nursing care at home—a child from its parents, a husband from his wife, a wife from her husband—than they would get in a hospital."

PHOTO: TONY ROMANO

Becker wrote a coloring book for children on getting ready for immunization. He wrote another book for women on preparing to have a baby. He served 10 years on the Joliet board of education and continues to serve as an officer of local and national medical organizations in environmental health sciences, allergic and internal medicine and professional standards review.

With physician accountability continuing to occupy his mind, he went to California in the 1960s to visit the San Joaquin Foundation, a pioneer nonprofit doctors' organization that did peer and fee review and managed medical care. Then he and the Joliet medical society started a similar foundation, and he became its first president.

He read General Accounting Office studies of the Medicare cost savings resulting from newly mandated "utilization review" and saw health costs being shifted from government to private payers.

"Eventually I was spending four or five months a year away from my practice on organization work," he says. "By 1982 I realized I had to make up my mind either to be a full-time practicing physician or become an administrative physician."

His decision was the start of HealthCare COMPARE. Becker began consulting with legal and medical friends to plan an organization. He also started looking for money.

Over the next 18 months he raised $200,000 and borrowed another $700,000 from a bank, putting up his house, his profit-sharing plan and even his safe-deposit box key as collateral.

"I learned what every entrepreneur knows—that you exchange one pound of security for two tons of insecurity," Becker says.

For his new organization he hired "top-level people" who had experience in medical utilization review. He set up a computerized data system and a phone bank, hiring registered nurses to take calls and do initial screening. The nurses make about 70 percent of the medical judgments; doctors handle the more challenging questions and consult with patients' physicians.

"I worked 18 to 20 hours a day," Becker says. "I was the only one beat-

ing the bushes for business. I also became the team cheerleader, bolstering employees concerned about having put their security in jeopardy."

The business did not get rolling until the next summer, when a major food manufacturer signed up. And eventually it became clear that the company, still being run by medical professionals, needed a good business manager. Becker coaxed an executive away from Texas Instruments Corporation and made him president.

In addition, the company needed new financing. It came from a group of seven private investors (none physicians) who made a commitment for $5 million. Becker's stake in the company fell to 20 percent. "I had to give up being majority equity holder," he says, "in return for continuing to control the corporate philosophy. But I've never been interested in dollars. My wife would kill me for saying that."

The company now has 35 employees. Recently it set up an outside sales force and hired a national sales director. After first concentrating on middle-sized insurance companies (and signing up a dozen), the firm began marketing its services to third-party health plan administrators. Its next target will be self-insured employers.

Throughout the firm's history, its marketing approach has been to promote the cost-containment service as a "free choice" alternative to health plans that restrict patients to using certain doctors or clinics. Doctors and patients alike benefit from the free choice, Becker says.

HealthCare COMPARE, now growing 20 percent a month, is rated among the leading firms in its field. It has one of the broadest offerings of services, from pre-admission screening to second surgical opinions to disability reviews. It covers 350 companies in 48 states with 300,000 to 400,000 employees and expects to triple its coverage in the next fiscal year.

What advice does Becker have for anyone considering starting a business?

"Think up a product or service. Take a pragmatic business approach. And get adequate financing."

What would he do differently if he could?

"I would have brought in a businessman earlier. I would have developed the data system earlier. And I would have warned my wife in advance of what we were about to get into."

—Harry Bacas

Vending Machine Cuisine

Food Specialties Service President William Farhat (right) joins brother Lawrence (center) and Jerry Wright, vice president, in readying items for delivery to vending companies.

William R. (Bill) Farhat was a restaurateur in Grand Rapids when some representatives of vending companies asked him if he could make sandwiches for their machines.

"With a restaurant kitchen, it really wasn't possible," Farhat recalls. But he asked the vendors if preparing food was a problem for them.

It was. "They were in the food business," he says, "but they really didn't want to be." The job of a vending company is to find locations for machines and service them, not prepare food.

Farhat had been spending 16 hours a day, including weekends and holidays, on his restaurant. That was all right when he was single, but now that he was married and a father, he wanted a lifestyle that would accommodate his family. The conversation with the vendors showed him an opportunity to get out of the restaurant business. Why not start a company that would supply vending firms with food they typically prepared for themselves, but do it better and cheaper?

His chance came when the owner of Schneider Vending Company in Buchanan, Mich., asked him to run its food preparation operations.

"I told him I wanted to do this sort of thing not just for him but for others," says Farhat. An agreement was reached: Farhat would lease the Schneider commissary, preparing food both for Schneider and for other vending companies, including the ones in Grand Rapids that had initially asked for his help.

It was the beginning of Food Specialties Service Corporation. Three years later, in 1974, Farhat moved into a building of his own. Today the company, still located in Buchanan, employs 68 people and brings in annual revenues of $3.5 million. Expansion into Wisconsin, Illinois and Indiana (with Ohio on the way) necessitated moving into larger facilities last January—this time a brand new 22,000 square-foot $750,000 plant.

Farhat, the firm's president, has taken advantage of developments that have reshaped the vending industry. New generations of equipment made it possible to sell, via machine, not only simple items like candy and cigarettes, but also such foods as beef stew and casseroles. Microwave ovens near banks of vending machines enabled customers to heat food they bought. Machines able to accept more than $1 are even making it possible to push the price structure up so that even more sophisticated items can be offered.

To meet some of the challenges, Farhat, 51, brought his brother Lawrence, a prize-winning chef, into Food Specialties in 1979.

"In the first meeting I had with my brother, he said, 'I'd like you to design six casserole items, and the food costs should be 26 to 28 cents each,'" Larry Farhat recalls with a chuckle. "Until that time, the garnishes on my plates were more expensive than that."

Larry, 58, oversees research and development. His office, which includes a small test kitchen, overlooks the company's production area. There, more than 135,000 items a week—ranging from chocolate pudding to spaghetti dinners—are prepared for 70 clients. Menus listing about 175 choices are rotated every three weeks.

But, says Bill, "We don't sell individual items. We sell a total food program." By that, he means making up custom products for specific clients as well as products that all clients buy, labeling all the items with the clients' names. Products are delivered to clients' walk-in coolers every day, sorted according to the clients' routes and even the machines on those routes.

"We operate on a very close margin—on fractions of a penny in many cases—but we do it on a volume basis," says Larry. That volume, combined with the company's expertise, makes for prices and service that most vendors cannot readily match on their own.

Larry admits he had some trouble making the transition to serving the vending industry. "One problem I have as a chef is that I don't have feedback from my dining room. When you're in a country club and someone doesn't like the soup, you hear about it immediately. And if they do like it, you also hear about it immediately."

At Food Specialties, he says, it can take 90 to 120 days for a complaint to reach his office and even longer for a compliment.

Bill Farhat hopes eventually to have someone else do the sales work he is now doing and to become more involved in expanding his company. Instead of trying to serve the country from one location, he says, he would open plants in different regions so clients could get the products fresh.

He foresees setting up shop where manufacturing and thus vending sales are strongest. But as manufacturing declines, he thinks vendors will be serving more office complexes and schools.

Farhat admits that he has not totally eliminated the 16-hour days that made him leave the restaurant business. But at least he is usually home on weekends and holidays now.

—*Sharon Nelton*

A New Kind Of Retirement Home

Jerry Frishberg chats with one of the residents of his Philadelphia life care center and her visiting daughter. He says the dining room compares with the finest restaurants in the city.

PHOTO: STEVEN GOLDBLATT

Once Jerry Frishberg was just a certified public accountant. Today he is conversant with real estate development, food service, health care, gerontology and cutting red tape.

That is because Frishberg, former controller for Magic Marker Corporation in Mt. Laurel, N.J., is now chairman of Life Care Communities Corporation, a pioneering Bala Cynwyd, Pa., company that develops "life care" retirement centers for the elderly.

Frishberg first heard of such centers in the late 1970s, when he was looking for an appropriate place for his aging mother to live. The facilities offer older people the opportunity to live as independently as they can but provide nursing and other care if needed.

"I fell in love with the concept," says Frishberg. But waiting lists for facilities near Philadelphia, where his mother lived, ranged from four to six years.

"I put on the hat of an entrepreneur, along with the hat of my mother's child, and said, 'There's a tremendous need here!'" recalls Frishberg.

He quit his job, and he and his wife mortgaged everything they had to borrow $1 million. With it, they acquired an idle school on 22 acres in Broomall, Pa. With the help of partners, Frishberg began to turn it into Martin's Run, a Jewish-oriented life care community.

When legal problems delayed the project a year, Frishberg turned the setback into an opportunity for education. He visited retirement centers around the country and enrolled in a University of Pennsylvania graduate program in social gerontology. But he became too busy to finish work on a master's degree—"one of my disappointments," he says.

Martin's Run was completed in 1980. Meanwhile, Frishberg set up Life Care Communities Corporation. But on the advice of attorneys, who felt a profit-making corporation could not legally run Martin's Run because it had been financed with tax-exempt bonds, the facility was turned over to a nonprofit corporation. Frishberg's mother, who died in 1984, was among the first residents.

Frishberg turned his attention to building a second nonprofit center, Logan Square East, a $50 million, 320-unit luxury high-rise in downtown Philadelphia. A facility was needed, he says, for older people who wanted to live close to cultural activities, restaurants and shopping.

The residence features an elegant dining room that Frishberg says rivals Philadelphia's finest restaurants. Many apartments offer stunning city views, and a recreation floor includes a spa with a 12-seat Jacuzzi, a library, a craft room, a TV room and an auditorium

that is used for meetings and dancing. A 148-bed nursing home occupies a separate section of the building. Entrance fees range from $51,000 to $99,000, depending on the model of apartment, with monthly service fees starting at $850 for an individual and $1,300 for a couple.

Frishberg and his attorneys have grown more knowledgeable—and confident—about what can be done under the law, and Life Care Communities Corporation has stayed on to manage Logan Square East for a nonprofit corporation. LCCC went public in 1983, raising $3 million, and has now opened a third community, the company-owned profit-oriented Court at Palm-Aire in Pompano Beach, Fla. Other centers—profit and nonprofit—are planned for Lakewood, N.J.; Silver Spring, Md.; Boston and Chicago.

Calling on his accounting background, Frishberg has come up with innovations in the life care field. Traditionally, the hefty entrance fees (a median of $44,950 for a one-bedroom apartment last year, according to one study) went to a church or other nonprofit sponsor when a resident died or left a facility.

Frishberg worked out a way to return the entire entrance fee at Logan Square East. And at the Court at Palm-Aire, the resident or his estate not only can get the entrance fee back but also can have a chance, through a stock program, to make a profit on it.

"Now," says Frishberg, "you're in a position where you can leave increased value to your heirs and not feel guilty that you're using up your money for your life."

—Sharon Nelton

Computers That Are Tolerant To A Fault

William Foster of Stratus Computer has tapped the market for computers that big companies can depend on.

PHOTO: T. MICHAEL KEZA

In the computer industry, the key to success is usually to build a better "box" for less money. But William Foster, the lanky, fair-haired president of Stratus Computer, Inc., of Marlboro, Mass., put four boxes in one—and reaped a bonanza in the process.

Stratus makes four-in-one fault-tolerant computers. Two computers do the same work. If one fails, both shut down so the good machine can preserve data the failed one may have lost. Meanwhile the other two computers kick in. The machines, which range in price from $200,000 to $400,000, are only marginally more expensive than standard computers of comparable power because the extra semiconductors represent a tiny piece of the total price, Foster says. The computers are also housed in the same cabinet and share the same power supply.

"The demand for our product is almost unrelated to what is going on in the economy," Foster says. "If there is a recession, that may actually strengthen demand. Customers have even more incentive to use our computers to reduce the size of their work force."

Stratus' track record is phenomenal. In January, 1985, Stratus signed a contract with IBM to supply Big Blue with its machines under private label. Sales at the publicly held company were $54 million for the first nine months of 1985, and net was $5.6 million, compared with $28.1 million in sales and a net of $3.9 million for the same period in 1984.

Before he started the company in 1980, Foster was vice president of software development at Data General Corporation, the big, Westboro, Mass., minicomputer company. Before that, he was engineering manager of the computer division of Hewlett-Packard. Still, he needed a good feel for what would fly in the marketplace to complement this advanced knowledge about computer architecture.

A lot of big companies, ranging from banks to airlines, need big computers whose performance they can depend on. Some firms buy two big computers and link them together, but that is a complex solution requiring exceedingly elaborate software.

"Unlike most computer companies, we don't have scores of competitors," Foster says.

Indeed, Stratus really has only one: Tandem Computers, Inc., of Cupertino, Calif., which created the fault-tolerant market in 1974.

Tandem builds two computers in one, rather than four, and relies on software to kick the second computer in if the first fails.

Although the market clearly is hot for fault-tolerant computers, Stratus is the only company that has been able to loosen Tandem's stranglehold. More than a half-dozen fault-tolerant startups went into business at around the same time as Stratus.

Like Tandem, they tried to rely on a software, rather than a hardware, approach. But they tried to establish themselves at a time when the cost of software suddenly started to soar and the cost of hardware began plummeting.

"These start-ups could not convince themselves that hardware was cheap enough to do fault tolerance our way," Foster says.

—Steven B. Kaufman

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TECHNOLOGY

How The Split Hits Small Firms

By Karen Berney

It is my opinion that only companies that have large long distance charges are benefiting from the breakup. The average small to medium size company is now paying for those cost reductions.
—Bill Kirchner, agent, State Farm Insurance, Lake Orion, Mich.

I have subscribed to Allnet for long distance calls, but what we save on that in no way compensates for the change in monthly charges plus all the other additional listing of services for which we are now charged.
—Margaret S. Smith, owner-partner, C.E. Sickeker Hardware and the Basket Loft, Sewickley, Pa.

As a small business user we have been adversely affected by the breaking up of AT&T. Very simply, our basic monthly charges for equipment and service changed from $373.51 to $563.19, an increase of 51 percent. Our average monthly savings on long distance is $25.
—R.B. Emanuel, Ullman & Emanuel, Inc., Norfolk, Va.

Since the breakup of AT&T two years ago, there has been a proliferation of telephone equipment. Businesses often do not have the time to sort through the options.

PHOTO: T. MICHAEL KEZA

AT&T Chairman and Chief Executive Officer Charles L. Brown says that small business users have been hit hardest by post-divestiture fallout.

PHOTO: AT&T

In the good old days there was one telephone company, American Telephone & Telegraph, providing a level of service at a price that was the pride and joy of America and envied the world over. Then came Jan. 1, 1984, marking the court-ordered splintering of AT&T's monopoly. Ma Bell gave birth to 22 offspring regrouped as seven large regional phone companies, a regrouping that set off mass confusion over changes in telephone service.

Two years after the breakup, the dust is settling as customers get acquainted with the different players and their new roles. But while many firms are successfully managing in the new marketplace, some, particularly small businesses, have yet to reap any of the promised competitive benefits.

In letters like those above, sent to the Federal Communications Commission over the last year, small business people say they not only see few of divestiture's benefits, but also believe they are bearing the brunt of its ill effects. Indeed, AT&T's chairman, Charles L. Brown, who often says he was no advocate of divestiture, told NATION'S BUSINESS, "It is true that largely the benefits have come to large businesses, which have wider choice in making long distance calls."

Since the breakup, local telephone rates have risen 20 to 30 percent, reports Sam Simon, executive director of the Telecommunications Research Action Center, a consumer lobby group. Though long distance charges have declined about 15 percent, the imposition of a $6 per line access charge to connect to the local telephone loop has virtually wiped out potential gains to small businesses from cheaper long distance service.

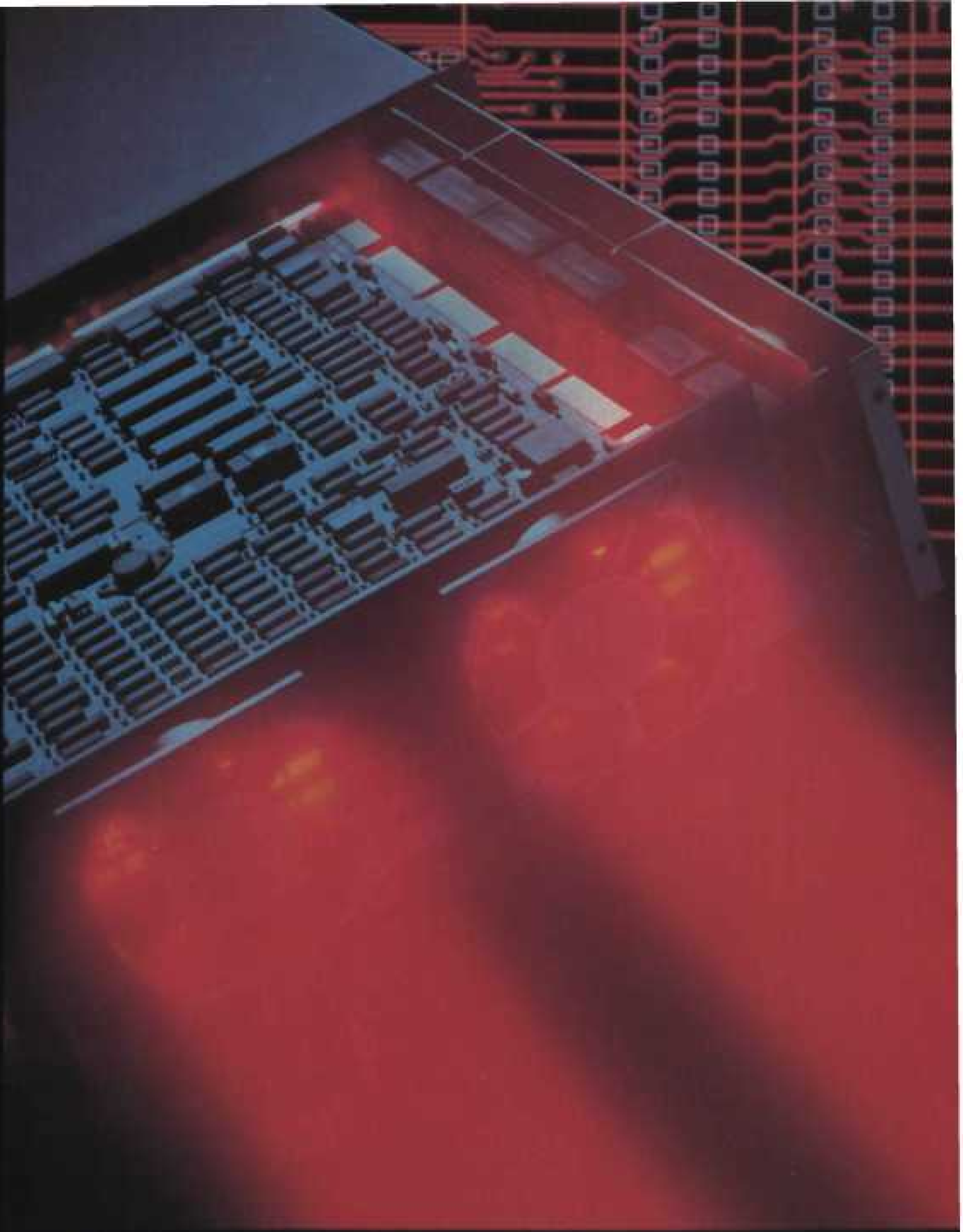
AT&T says 86 percent of U.S. businesses make less than $50 worth of long distance calls a month. If you own a small business with eight telephone lines you are probably losing $4 a month, says Simon. As a result, firms like Mitsi Corporation in Helena, Mont., are "going back to mail on any ordering or communications to business contacts to cut telephone costs," says a Mitsi spokesman.

An even bigger shock is coming, says Simon. The Federal Communications Commission, responding to phone companies' requests for local rate hikes to offset lost business from "bypass," is planning to boost access fees to about $11 per line by 1990. (A bypass is a direct connection of a private network to long distance lines, which avoids local connections and access charges.)

Furthermore, wider use of measured service—a pricing scheme that meters each call by duration, distance and time of day—has the potential to "kill off small business altogether" if it becomes universal, contends Simon. Many state utility commissions are considering proposals from local phone companies to make measured service mandatory (it is still optional in 42 states).

Divestiture's impact on small business is no surprise. It eliminated some $10 billion a year in subsidies of local Bell operations that AT&T had been drawing from its heavy-volume long distance users. In return for paying more for phone service, however, users were supposed to benefit from a proliferation of innovative services and low-priced phone equipment.

Since the Bell system split-up, there have been "remarkable improvements



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The AT&T breakup has not exactly been a break for many small businesses. A dose of education might be good for what ails them.

in the variety, functionality and price-performance ratio of telecommunications equipment and services," says Joaquin J. Gonzalez, an analyst with the Gartner Group, a Stamford, Conn., market research firm. Unfortunately, he says, small business is least able to take advantage of them, and for that users and producers are equally to blame.

Nearly all observers agree that divestiture has fostered competition. There are now about 70 manufacturers of phone equipment. Equipment prices have dropped an average of 25 percent, and the long distance market is swarming with more than 400 companies. In both arenas a shakeout is under way.

Bankruptcies, mergers and acquisitions are expected to shrink the long distance industry to a handful of carriers. Divestiture may have divided the pie, say the experts, but it did not make the pie bigger.

For now, though, small companies are finding it difficult to sort through all the subtle differences among the players. Says John Korsmo, president of Fargo, N.D.-based Cass County Abstract Company: "Frankly, I couldn't tell you if I am getting the best deal for my money, because with only three lines and 11 employees it doesn't pay for me to spend the time to comparison shop."

John Bender, president of Bender Lumber Company, Bloomington, Ind., did comparison shop but says, "I got swayed by all the embellishments." He bought an expensive phone system with a lot of features only to find that half his employees don't use them.

Competition has accelerated the introduction of innovative products, but "they generally apply to the large situation where leverage is high," says AT&T's Brown. As communications and computer technologies merge, "unit costs of both are going to come down to the point where they are available to all businesses," he adds.

Indicative of that trend is AT&T Information Systems' "Merlin," a low-cost, 2- to 10-line system that offers computer features—simultaneous voice/data transmission, automatic routing—previously only available on expensive systems. Norman Neiss, owner of an AAMCO transmission franchise in Bethesda, Md., says Merlin is a great system that proves divestiture is working, but "because it would take six years to pay it off, I can't justify buying it." Like many other business people, Neiss is waiting for prices to hit bottom before he invests in a new phone system.

Bal Dixit, president of New Tex Industries, says that higher costs after the breakup motivated him to consider new ways of running his business. Now he is using a computerized electronic mail system instead of a telephone-based telex and reports saving money as well as having access to a host of new services.

PHOTO: DENNIS R. FLOSS

The most common complaint, however, is that post-divestiture products and services are unnecessarily sophisticated technological marvels with no place in the market. Vendors describe revolutionary developments still many years away, notes the Gartner Group's Gonzalez. "They [users] are being told they must prepare for the much ballyhooed arrival of ISDN, which is really Indicative of another Service they Don't Need." (Actually, ISDN stands for the integrated services digital network that would transmit voice, data, and video signals over one unified channel.)

Like the computer industry, the telecommunications industry has seen sales slowed partly because it has failed to relate technology to specific applications the user understands and needs, says Gonzalez. "In the past, the small business market has suffered from benign neglect," says a spokeswoman for AT&T Information Systems. But she says steps are being taken to address the imbalance.

As an example she cites the launch of a new program, the Small Business Connection, aimed at tailoring maintenance and repair services to the specific conditions of local businesses.

Hayden Constance, Bell Atlantic division manager for market delivery, says the company's 1 million small business users account for $1.2 billion or 12 percent of total revenues. They are also increasingly the target of new reach-out programs such as free seminars sponsored with the Small Business Administration. The aim is to show "how new technologies can make a difference to even the one-telephone business," she says.

At the same time, small users could more fully exploit the opportunities that do exist. "Basically there are two options: You can stick your head in the sand and do nothing, or take the initiative and get educated," declares Burnes

How The Split Hits Small Firms

Hollyman, a telecommunications analyst for Peat, Marwick, Mitchell & Company. For instance, he says, packet switching, a transmission technique that cuts costs by interspersing packets of data from many customers on a single channel, is often cheaper than leased telephone lines for connecting computers. Paging, cellular telephones and telemarketing are other new technologies that can save money for businesses large and small, he adds.

Bal Dixit, president of New Tex Industries, Inc., Victor, N.Y., is one businessman who decided to take control of his telephonic destiny. After the AT&T breakup, he found that the charge for using his telex had risen from $44 to $100 a month. Now he spends $40 monthly by using Western Union's Easy Link electronic mail system for data communications. Though his costs are near what they were two years ago, Dixit says he is benefiting in ways he never imagined: "By using the system to search for patents, I avoid the high prices charged by attorneys."

Says Hollyman: "You can view divestiture as either a threat or an opportunity." The winners, he says, will be those who learn how to use telecommunications as a strategic weapon.

For those who lack the time and resources needed to make choices, help may be on the way. Last July the FCC lifted restrictions that barred two AT&T subsidiaries, AT&T-IS and AT&T Communications, from marketing their respective computer and phone equipment and long distance services through one unified sales force. AT&T and Bell operating companies expect to get relief from similar rules requiring them to house basic phone service and computerized offerings, such as packet switching and call storage and forwarding, in separate subsidiaries. They argue that such prohibitions are unfair now that competition is flourishing. IBM has purchased ROLM Corporation, a manufacturer of telephone switching equipment, and a stake in MCI Communications Corporation.

Thus, while the days of the telephone company that is all things to all people are gone—AT&T will never be pieced back together—the local telephone company is evolving into a facsimile of the one-stop shop. It could soon be stocking just about everything you need except long distance service. NB

To order reprints of this article, see page 85.

Selecting A Telecommunications System

At a time when vendors well versed in showmanship are overwhelming businesses with equipment and service options, it is easy to put off your telecommunications problem until tomorrow. And tomorrow rarely becomes today.

If you have done nothing in this area since the breakup of AT&T, "you are probably leaving money on the table," says Burnes Hollyman, a telecommunications analyst for Peat, Marwick, Mitchell & Company. Experts agree that buying your own telephone system is the cheapest way to go in the long run, though it requires assigning someone the time-consuming task of becoming literate in telecommunications. Here is a summary of their advice:

- Get a handle on your telecommunications needs by asking whether your current phone system is doing the job—receptionists are usually the best people to ask. When they are swamped with calls, can they juggle a multitude of lines comfortably and accurately? Can their telephones also manage other special features that might be important, e.g., call forwarding and conference calling? If all is not running smoothly, figure out what you need in terms of number of lines, phones and features.
- Decide on the performance and management features you want. Performance features, the "bells and whistles," are standard and easy to use on most systems, though price and quality differ widely. These features include not only call forwarding and conference calling, but also automatic dialing and redialing. It is possible to store in the phone as many as 40 telephone numbers and make a call using only one digit instead of 7 or 10. It is also possible to simply press the automatic redial button to call the party you last tried to contact. Some telephones even have clocks, alarms, timers and calculators. Management features include: SMDR (station message detail reporting), a built-in device that tracks date, time of day, duration and station of incoming/outgoing calls and collects information on number dialed and telephone carrier used; routing over the least expensive line; and internal controls on employee phone use.
- Analyze your service costs. Study a few months' worth of your long distance telephone bills and identify calling patterns. Most long distance carriers will take your results and tell you what the service would cost according to their rates. This is a good way to compare various carriers and choose the most economical bundle of services.
- Specify a budget and draw up an RFP (request for proposal) specifying number of lines and features. Issue the RFP to as many telephone equipment suppliers as you can find in the yellow pages. That includes independents, which install the brands of many manufacturers, and the equipment subsidiary of your local phone company. The supplier will provide a system design broken down in price by component parts and installation.
- Make sure your vendor will be around next year, can get replacement parts fast, and can meet service and warranty agreements. Competition in the equipment business is fierce, and there are casualties every day.
- Look for devices other than telephones that can save time and money and improve productivity. Pagers, for instance, offer simple, low-cost two-way communications for businesses with employees working off site. The cellular telephone is still a high ticket item but should be considered if you are losing sales because you can't reach customers while on the move. Telemarketing is a cost-effective way to run a promotional campaign; the regional Bell operating companies give free courses on its applications.

A general rule of thumb: Once you are planning for more than 50 lines, you need the advice of a telecommunications specialist.

PERSONAL/FINANCE

A Dowager Named Jones

Wall Street critics question the viability of the nation's venerable stock average index.

By Ray Brady

If there has ever been a stock market indicator that has the power to arouse controversy, it is the Dow Jones Industrial Average. But critics say that it has become outmoded—a kind of old lady of Wall Street—and that it does not really reflect the stock market. Other measures, such as Standard & Poor's 500-stock average or the New York Stock Exchange Index, give a far better indication of what is really going on, they argue.

Cases in point:

One week this fall, the Dow hit a new high, while the other indicators were just sort of ambling along, nowhere near to setting highs of their own.

On other days, when the entire market was nearly moribund, the Dow went merrily skipping up its own curve. But the reason, as numerous critics pointed out, was one stock in the Dow: General Foods. In the space of three to four weeks, analysts estimate, the astronomical rise in that one stock (which was being taken over by Philip Morris) contributed nearly 35 points to the rise in the Dow.

All this brings a snort of disdain from Larry Wachtel, a vice president with Prudential-Bache Securities. "It's a careless, lazy way to approach the market," he says. He says the Dow "has become more and more of an anachronism."

But just why do critics use terms like "anachronism" and "old lady" to talk about this most widely known of stock market measures?

History alone may have something to do with it. The Dow *is* old. Back in 1884 when Charles Dow began adding up the share price of 11 big companies, his average was just that: He added up the price of the stocks and divided by 11. (As one sign of how business times have changed, 9 of those 11 original stocks were railroads.)

Over the years, the average grew. One year before the stock market crash of 1929, the Dow reached its current number of 30 stocks.

Many of those early 30 are still on the list. They are companies like General Motors, American Can, Texaco and Standard Oil of New Jersey, now known as Exxon. Gone, however, are such storied names as Nash Motors, Wright Aeronautical and Victor Talking Machine.

Ray Brady is the business correspondent for CBS News.

The Dow Jones Industrial Average is based on the stock prices of these 30 large companies. Critics say the Dow is outmoded.

Though some of the stocks may have changed, critics bristle at the fact that the Dow contains stocks that make up only about 25 percent of the total capitalization of the New York Stock Exchange. "It's just 30 stocks," says Norman Fosback, editor of an investment newsletter, "and not a representative 30."

With such a low number in the measure, individual issues, as demonstrated in the case of General Foods, can have major influences on the Dow.

That brings up another criticism of the Dow. Obviously, as stocks were added or dropped or as some of the stocks were split, the total could not simply be divided in the manner of Charles Dow.

So Dow Jones & Company and editors of the *Wall Street Journal*—the guardians of the average—came up with a divisor, a mathematical way of adjusting the Dow for all the financial changes that might destroy its historic continuity.

That divisor is now 1.090. If the net price change in the Dow stocks comes to a total of 10 points, the average would show a gain or loss of 9.17 points. William LeFevre, a Wall Street market strategist who is a close student of the Dow, says that as the divisor drops the Dow itself becomes more and more volatile.

Still, is the old lady all that bad? Michael B. O'Higgins, an investment counselor in Albany, N.Y., swears by the Dow. O'Higgins manages $75 million of clients' money by investing exclusively in Dow stocks. Usually, he says, he has managed to outperform the average itself.

While few other investment counselors put money only in the Dow, many are measured by it. Some of the nation's highest paid money managers receive their compensation based on how well they did compared with the Dow.

Recently the Dow added two new stocks: Philip Morris, the big cigarette maker and a top producer of beer and soft drinks, and McDonald's. Those stocks replace Philip Morris' acquisition, General Foods, and American Brands, another tobacco company, and analysts feel they could make the old lady even friskier than she has been at times in the past.

Indeed, all the signs are that, for all the times the Dow has been cursed, reviled, mocked and denigrated, the old lady of Wall Street is going to be around for many years to come. For millions of Americans—looking in their newspapers or watching the news on TV—the Dow *is* the stock market.

If you don't believe it, wander through any trading room on Wall Street, and listen to the professionals. Snatched between rapid-fire chatter on the telephones, the exchange usually goes like this:

"How's the market doing?"

"So far, it's up eight points."

That's the Dow Jones Industrial Average they are talking about. NB

THE NATION'S BUSINESS

Where I Stand

Results of this monthly poll on important public policy issues are forwarded to top government officials in the White House and Congress.

1. Reject Tax Plan That Hurts Growth?

A House Ways and Means Committee tax bill that, by changing depreciation and tax credit rules, could cut business investment more than $100 billion over five years has gathered support in Congress. Proponents say this "reform" measure would help eliminate tax considerations from spending decisions. Foes say it would cripple business efforts to increase productivity and competitiveness in world trade, hobbling economic growth. Should Congress enact this tax plan?

2. End Natural Gas Price Controls?

Last January, price controls were lifted on natural gas discovered after April, 1978. Prices are frozen on the 40 percent of gas supplies found before then. One result of continued controls: Customers of one pipeline can pay as much as 2½ times what those of another pay for gas. The federal agency that regulates interstate gas shipments has issued 800 pages of rules it says will help narrow the gaps. Others say a better way is the free market way. Should natural gas price controls be eliminated?

3. Use Tolls On One Road To Pay For Others?

Congress will consider using tolls collected on existing roads, as well as motor fuel taxes, to pay for new federal highways and repair of older ones. Traditionally, toll revenues have been used only for the roads they are collected on. Critics say tolls are not cost-effective: It takes 15 cents to collect a dollar instead of the 1 cent that fuel taxes cost. Advocates say tolls keep fuel taxes down. Should tolls be used to help pay for new roads and repair of others?

Verdicts On Exports, Sales Tax, Small Business Capital

Here is how readers responded to the questions in the November issue's Where I Stand poll.

	Yes	No	Undecided
Should export sanctions be used as a tool of U.S. foreign policy?	29%	58%	13%
Should Congress enact a business transactions tax as part of a revenue-neutral reform package?	26%	65%	9%
Is the hybrid debt-equity security called a small business participating debenture a good idea?	35%	46%	19%

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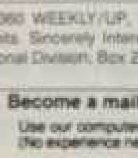

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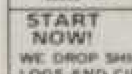

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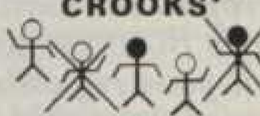

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PERSONAL/TO YOUR HEALTH

A Pill In Time

Failing to take prescribed medications, or to take them on schedule, can cause serious health problems.

By Nancy Stalker

Mention the term "drug abuse," and most of us think of illegal substances taken for recreational purposes. But there is another form of drug abuse that is hazardous and common in our society.

The problem is prescription *misuse*, and as many as 60 percent of us are guilty of it. In medical terminology it is referred to as *noncompliance*, but in everyday terms it means not taking medication as prescribed.

We may rush to get a prescription filled and take the medicine religiously for a few days. But we start to slacken off because we forget to take the pills with us when we go to work, or we get up late, or we don't eat and the medicine must be taken with food.

These and other factors—such as changing dosages on your own or sharing prescriptions with someone else—can result in a problem that is not properly controlled and sometimes, especially with the chronically ill, can cause hospitalization.

Research indicates that noncompliance is for one of these reasons:

- You stop treatment when you feel better.
- Your problem does not seem severe enough to warrant medication.
- Alarming or unexpected side effects from the drug cause you to stop treatment.
- Directions are not clearly explained or understood.
- The prescribed medication schedule does not fit your daily lifestyle.
- You forget your medications.
- You do not understand why a drug is prescribed.
- You have a negative attitude about medications.

The most important factor in appropriate medication taking is communication between you and your doctor or other health care specialist. Your doctor can design or alter a treatment program for you only if he or she is aware of difficulties you may be having.

Discussing such difficulties may also eliminate needlessly increasing or changing medications. Proper treatment includes prescribing the lowest medication dose possible to control your problem.

The most important factor in taking medication is communication between you and your doctor or other health care specialist.

PHOTO: SUSAN BONAK

Perhaps the most common mistake we make when taking medication is skipping dosages. Though it is the physician's responsibility to prescribe as little as possible of the drug needed to complete the treatment, it is the patient's responsibility to take it properly. You should not stop when you are feeling better. Try not to forget doses, and don't cut back, such as from four times to twice daily.

Many asthmatics must take theophylline, a commonly prescribed drug that must rise to adequate amounts in the blood to be effective. This usually takes 24 hours, so not taking the medication as prescribed prevents it from doing its job. Such noncompliance can result in an asthma flare-up—and an emergency room visit or hospitalization.

A similar situation exists with treatment for chest pain, or angina. Many patients are on such medications as Isordil or Procardia, which need to be taken three or four times daily. Not taking the prescription as required can increase chances of anginal episodes.

Many high blood pressure patients find it difficult to stick with treatment because their condition is a long-term problem. You may feel fine without medication; when medication is taken, side effects may cause you to feel worse. If you do not follow a prescribed treatment regimen, however, you may unknowingly have too-high blood pressure until your next measurement.

Here are some guidelines to help patients combat medication misuse:

1. Be sure you understand the directions for using your prescriptions, including how often and for how long medication must be taken. Many medications, such as antibiotics for strep throat or an ear infection, must be taken for a full course to ensure that treatment is complete, even though symptoms have disappeared.

2. Be sure you understand the goals of your treatment. This is especially important for problems for which you have no symptoms, such as high blood pressure. HealthAmerica, a San Francisco area health maintenance organization, gives high blood pressure patients wallet-size records of their blood pressure readings so they can see how effective it is to take their medication.

3. Ask about common side effects and how they can be minimized. Instead of stopping the treatment because you feel nauseated, call your doctor to discuss the options.

4. Discuss the medication schedule with your doctor and be sure to alert him to times that do not fit your daily schedule. Some medications can be prescribed less frequently, or a similar but longer-acting medication can be prescribed. Some problems can be treated with a single dose of medication or a very limited treatment course.

5. Ask your pharmacist for medication-taking aids that may help you in following your schedule—such as calendars and trays to hold pills.

Treating illness with medications requires close cooperation between the patient and the health care provider. You want the best medical care possible, and that means asking questions and expressing your concerns about your treatment. NB

Nancy Stalker is director of pharmacy services for HealthAmerica, a San Francisco Bay area health maintenance organization. She is also on the faculty of the University of California, San Francisco.

LESSONS OF LEADERSHIP

A Sales Plan Gels

An accountant who "always wanted to be a doctor" builds success on an ugly—but healthful—plant.

By Del Marth

Rex Maughan has made a fortune from natural products created from the aloe plant. His company's growth rate is soaring and, now that he has added bee products, the future is sweeter than ever.

The little foil-wrapped candies in the half-filled glass jar seemed out of place on the receptionist's desk. Store-bought and laced with artificial flavoring and preservatives, they were hardly what a visitor would expect to find in the headquarters of Forever Living Products, Inc., the au naturel empire of Rex Maughan.

A faux pas by a new employee, no doubt. For nothing within the antiseptically white one-story office building at Tempe, Ariz., even hints at impurity. There is no dust on the Western art paintings and sculptures, no ash trays on the tidy desks of the 50-some employees, no errant paper next to wastebaskets (in fact, no visible wastebaskets) and, one does not even need to ask, no lint in Maughan's pockets. Only money.

Of course, Maughan, 49, who admits to earning "more than I can spend," could not begin to carry even a fraction of his fortune on his person. But if his pockets do not bulge, his accessories do blind—a hammered-gold Western belt buckle with monogram and framed in diamonds, a gold ring set with diamonds, a presidential Rolex wristwatch framed in diamonds, a company lapel pin framed in diamonds. Then there are the ranches, in Idaho and Texas, in Wyoming and Arizona, and the. . . .

Well, it is obvious Maughan has reached his lifelong goal—"to be financially free."

And his fortunes keep growing as he logs in 15-hour work-days toward another goal—helping others become financially free and secure. The others are the more than 600,000 distributors that sell Forever Living Products, a line of bottled, jarred and tubed—consumable and unadulterated—health items.

Forever Living Products, Inc., is seven years old. Yet it has the world's third largest door-to-door sales network. Only giants Amway and Shaklee have more independent distributors, and neither can match FLP's soaring rate of growth: four employees and $1 million sales its first year (1978) to more than 500 employees and a projected $100 million in sales in 1985.

Maughan owns it all, lock, stock and barrel—the plantations in the Lower Rio Grande Valley, the processing plants and research labs in Dallas, the truck fleet, the 22,000-square-foot headquarters in Tempe, even resorts in several Western national parks to which the more prolific distributors are invited for cut rate vacations.

PHOTO: TERRENCE MOORE—BLACK STAR

And it has all been built on a prickly, unattractive and ancient plant—the aloe vera.

Part of the lily family, the aloe vera plant for years has carried the nickname "the first aid plant." Its extract, a gel, is as common a salve to many folks in the warmer climes as is a mustard poultice for the croup. Many grow a solitary aloe vera in the backyard or in a pot, rubbing the gel on burns.

Maughan, a master of marketing but a bantam botanist, admits the only thing he knew about aloe vera before he started his company was "that it was a plant . . . and I think I remember some mention of it in the Bible." He has since read that Cleopatra used the plant's gel to enhance her complexion and that Alexander the Great found it a fast-healing balm for treating soldiers' wounds.

But Maughan is a fast learner. Today he has millions of Americans (and foreigners) drinking it, shampooing with it, squeezing it on toothbrushes, dieting on it, bathing in it, suntanning with it, even spraying it on their cats and dogs.

"I always wanted to be a doctor," Maughan explains.

The family farm in Idaho was not that profitable, however; as a lad working alongside his two brothers and sister in the unproductive fields, he realized a long medical education was beyond the family's means. So was a four-year bachelor's degree, but Maughan managed that by working several jobs while attending Arizona State University (at

Tempe). He earned a business administration degree in 1962.

"Banker friends told me that no matter what I did in business, if I understood accounting and financial statements, I would have an edge on everybody else," he says. So he steeped himself in accounting courses. "And taxes," he adds. "I knew I was going to make money and I wanted to know how to minimize my taxes."

His first job, in the Phoenix office of Haskins & Sells, a national accounting firm, "involved working on large accounts such as Hughes Aircraft, so I got a good corporate education." Two years later a Phoenix real estate firm, Mayer Central Building Corporation, lured him with the title of general manager and double his previous salary. And three years later, in 1967, the Del E. Webb Corporation, headquartered outside Phoenix, promised him even bigger titles and salaries.

"I had hopes of becoming president of Del Webb," Maughan says. "I had risen to vice president and head of the corporation's real estate development and recreational properties. But I was the youngest corporate officer, had the lowest tenure, and there were a lot of people between me and the top."

He dreamed of owning his own company, selling something that was "a natural product and consumable—something unique if I could find it."

To that end, in January, 1978, while still at Webb, he began studying "multilevel, direct-sales companies such as Fuller Brush, Avon, Amway and the smaller ones." Multilevel sales networks are based on multiplication—that is, a distributor finds another distributor, the two of them find two more, the four sign up another four and so on.

With a friend who was in direct sales, Maughan drafted on paper a direct sales company that would "better compensate" sales people, be they distributors, supervisors or managers. The plan called for the usual profit on product sales but added a series of bonuses that accrue to salespeople at every level.

Satisfied with the plan, Maughan and his friend then began searching about for a product. They got lucky.

"We ran into a researcher who, along with two doctors, had developed medical uses for the aloe vera plant," Maughan says. "They had a small laboratory in Dallas. They had been working with the plant for 15 years and had discovered how to stabilize the gel and bottle it."

But the Dallas people were not doing too well. They had little marketing know-how, trying to sell their product mainly in health food stores. "People didn't know what it was or how to use it," Maughan says.

Maughan had the answer to that. His company contracted to take over the Dallas lab's sales. For an office, Maughan rented space in the Del Webb

The Dallas Cowboys' locker room is stocked with Forever Living Products.

PHOTO: MICKEY PALMER—FOCUS ON SPORTS

office building in which he was working as a Webb vice president.

Maughan says the key to FLP's success has been his goal to give distributors the opportunity to be financially free. He asks that they set goals "and then work at them systematically. It gives them motivation. And without motivation, people merely walk through the day to see if they can make it to 5 o'clock."

From a cash investment of $10,000, Forever Living Products recorded $1 million in sales in 1978, $10 million in 1979 and $30 million in 1980. That year, when he was 43, Maughan left Webb.

In May, 1981, the company acquired the assets and patents of the Dallas group. Sales rocketed to $70 million, making it the nation's sixth fastest growing private company in 1981.

"When that statistic came out," Maughan says, "I started getting a dozen phone calls a day, from brokerage houses and other companies, asking if I would sell, or merge or go public. I was not interested then, nor now. I'm still in it to help other people."

Sales have climbed each year. And in 1983 Maughan bought out his partner's half interest for "several million dollars." He is now president and chairman.

Today his company owns more than 1,000 southern Texas acres planted in aloe vera. Its boss, meanwhile, spends more than half his time traveling to such places as New Zealand, Australia, Africa and Japan to acquaint their populations with his products and set up distributorships.

"We don't advertise," says Maughan. "Our business is word-of-mouth."

And the word does get around. Olympic gymnast Kurt Thomas uses FLP's lotion to heal chapped and cracked hands. And Maughan sits at his desk behind two autographed Dallas Cowboy footballs, souvenirs given him by a team that stocks its locker room with FLP lotions and gels to heal grid injuries. In December, 1983, the company added a new line—another centuries-old elixir—honeybee products.

Long known as excellent natural health foods, bee pollen, propolis and honey now come in tablets and jars carrying Maughan's company label. The nutrient-rich and energizing pollen, the propolis (a sticky antibacteria substance used by bees to line their hives) and the honey are grown in high altitude desert hives "free of pesticides and contaminants," says Maughan.

"Obviously," he says, "I believe in high quality, and not only for our products. I try to make sure, for example, that I hire the finest people. You have to have good people to grow. Teach them correct principles and then let them govern themselves."

Of course, Maughan is not in the office often enough to do much direct managing. But when he is in, he is "Rex" to the staff.

His vice president of administration, Navaz Ghaswala, came with Maughan from the Webb Corporation and gets along with her boss "because he likes things done right, and so do I."

Maughan will not, for example, bring his two sons and daughter into the business after their college days until, and unless, they sharpen their minds in jobs elsewhere: "I expect them to do something on their own."

Even if they do, they will find it difficult to duplicate their father's success in so few years. And, Maughan adds, "I'm not through." Popping a couple of pollen pills into his mouth, he says, "I'm just starting my career." ■

COMMENTARY

Congressional Alert

This NATION'S BUSINESS feature advises readers how they can make their views known on important pending legislation. Correspondence to members of Congress should be sent either to U.S. Senate, Washington, D.C. 20510 or to U.S. House of Representatives, Washington, D.C. 20515.

ISSUE	BUSINESS IMPACT	BUSINESS MESSAGE
Tax Reform/ Simplification	Tax code reform proposals include repeal of the investment tax credit, substantial reduction of depreciation allowances and significant increases in business taxes. Tax increases, by raising the after-tax cost of work, saving and investment, would harm economic growth and the U.S. competitive position in world markets.	Members of the House and Senate: Tax reform should stimulate capital formation, encourage technological advancement, enhance international competitiveness and help create jobs. Legislation developing in Congress does not meet these goals. Tax reform should be set aside, and efforts should concentrate on reducing spending.
Grove City	Many small businesses may be bound by burdensome civil rights regulations if Congress approves a broad-based reversal of the 1984 *Grove City v. Bell* Supreme Court decision limiting application of certain civil rights statutes to educational institutions that receive federal funds.	Members of the House and Senate: Carefully consider the far-reaching impact of legislation designed to reverse the *Grove City* decision. Support the administration's alternative bill for a simple reversal. Oppose broad expansion of federal regulatory authority under the guise of reversal.
Comparable Worth	The comparable worth concept, assigning job value on a point system based on subjective evaluation, could be costly to businesses. Employers would be exposed to liability based on their paying market-determined wages.	Members of the House and Senate: Oppose the superficially appealing but fundamentally flawed concept of comparable worth. Implementation of this market-disruptive concept would be a serious error.
Immigration	Immigration reform could prove burdensome to employers if recordkeeping is made mandatory and criminal penalties are imposed for knowingly hiring illegal aliens. Likewise if new legal rights are created for aliens beyond those given citizens. Proposed legislation would set up a special Justice Department division to probe discrimination claims by aliens, and they could be entitled to reimbursement of legal fees.	Members of the House and Senate: In reform legislation, recordkeepjng should be optional, criminal sanctions should be eliminated, and new legal rights for aliens should not be created.
Product Liability	Businesses are faced with heavy insurance and litigation costs because of the sharp increase in product liability suits. Passage of a uniform law dealing with such cases could reduce the escalating cost of litigation. Businesses would then deal with a single standard rather than operate under many individual state laws as they do now.	Members of the House: Support legislation that would establish uniform rules in product liability cases in state and federal courts.
Freedom Of Information Act	Businesses face having trade secrets disclosed under the Freedom of Information Act, which provides public access to information produced or gathered by the federal government. On the other hand, such reforms as giving a company an automatic right to a court *de novo* review of a government ruling requiring it to supply information would help businesses protect confidential or proprietary information.	Members of the House and Senate: Support a requirement of a court *de novo* (new) review in a case where a company objects to an agency or department ruling forcing it to supply information that the company feels should be confidential.

COMMENTARY

Editorials

How to have continued economic cheer this year. And a racketeering law that went astray.

Making The New Year A Happy One For Business All Year Long

The New Year is always a time for optimism on what the next 12 months hold.

For business, the economy offers good grounds for good cheer just now. (See our annual business outlook, beginning on Page 22.) The experts see steady growth in the new year, and very few of the economic doomsayers who some months ago were predicting a recession for 1986 are being heard from these days.

But there is also a warning in the advance signals on business conditions in the new year: The anticipated growth will have to be guarded from unwise government actions that could stifle it and even bring on the recession that has been avoided so far.

Commerce Secretary Malcolm Baldrige puts the issue in the form of a challenge: "It is within our power to have a continued expansion." Conversely, it is within our power to choke off the expansion.

That would happen if Congress made the wrong decisions on the urgent fiscal policy issues now facing the country. The basic questions to be resolved include federal spending levels and the nature of any revisions made to the tax code in the name of fairness and simplicity.

Continuation of spending policies that keep the annual deficit in the $200 billion range would pose a major threat to the economy in 1986. So would enactment of tax law changes that discourage the type of investment that brought about the current economic expansion.

Another threat lies in the growing talk about tax increases as the only realistic way to bring deficits down.

Such increases would, of course, divert to Washington money that the private sector would otherwise put to good use expanding production and creating jobs. But some members of Congress appear to be willing to accept that diversion as an alternative to fiscal discipline. They don't want to make the difficult political decisions that must be made to curb or abolish programs that enjoy strong support from special interest groups.

The worst of possible worlds in 1986 would see the realization of all three threats: (1) refusal of Congress to end its profligacy in spending, (2) curtailment or elimination of tax incentives for growth and (3) tax increases. That is a surefire formula for a severe economic downturn, if not a depression.

Business should accept Secretary Baldrige's challenge and put on the strongest possible pressure to ensure that none of these threats becomes a reality.

The Secretary is reminding the nation that continued expansion through 1986 is not a matter of economic forecasting but of vigilance by everyone who wants to see the good times go on indefinitely.

Why You Need Protection From This Protective Law

During the 1950s and 1960s, organized crime used violence, fraud, bribery and extortion to move into many legitimate businesses. The crooks then used the same techniques against honest competitors.

In a move to halt such practices, Congress enacted the Racketeering Influenced and Corrupt Organization Act of 1970.

Honest businesses everywhere welcomed the law. Criminal penalties including prison terms, fines and divestiture were specified. The law authorized the government to pursue injunctions and other civil remedies, too.

But Congress also added a provision for award of triple damages to anyone whose business or other property is injured through "a pattern of racketeering activity" on the part of another enterprise.

Though Congress was aiming at organized, persistent criminal enterprise, the triple damages provision has resulted in a surge of civil actions against the very type of legitimate businesses the law was passed to protect.

The provision is being used in routine commercial lawsuits, including disputes over interpretation of contracts. The target of such a suit faces a threat of triple money damages as well as the highly adverse publicity of being sued under a racketeering law.

An American Bar Association task force found that only 9 percent of civil cases brought under the racketeering law involve allegations of organized crime-type activity.

Legislation pending in Congress would put the law's emphasis back where it was intended—on protecting legitimate businesses from organized crime. These clarifying amendments should be passed.

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